

Part A

1. Review of Progress in Disinvestment

In the Fifth Report, the Commission had indicated, in the form of a Statement, the action taken by Government on its recommendations contained in its first three Reports and subsequent decision taken by Government on the specific recommendations of the Commission as well as in continuation of ongoing Public Sector Reforms. The Commission has now taken note of the progress so far in implementing the recommendations of the Commission in its five Reports. The Commission is pleased to note that subsequent to its Fifth Report, Government is firming up plans for sale of Government equity in GAIL, CONCOR, and Indian Oil Corporation during the current fiscal year and that decisions have been taken on some of the recommendations of the Commission made in its earlier Reports such as granting greater autonomy to PSUs and induction of non-official directors.

The Commission also notes the decision of Government to dismantle the Administered Price Mechanism (APM) in respect of petroleum products in a phased manner. The Commission had in its Third Report recommended that disinvestment of companies dealing in petroleum products should be preceded by an announcement of dismantling of the APM so that it would enable enhancement of their share values. The Commission therefore hopes that the disinvestment process for the oil companies would now commence.

The Commission would, however, urge that decisions to be expedited on other important areas such as creation of the Disinvestment Fund, offer of shares in domestic market, revamped Voluntary Retirement Scheme, Employee Pension-cum-Insurance Scheme, counselling service to those taking VRS and safeguards to officers and staff for bonafide commercial decisions. The Commission would like a definite time-table to be set up by Government for time bound action to eliminate further delay in implementation of the recommendations of the Commission.

Part B

2. SPECIFIC RECOMMENDATIONS

2.1 Electronics Trade & Technology Development Corporation Limited

Evolution

Electronics Trade & Technology Development Corporation Limited (ET&T) was set up in 1974 with the main objective of setting of strengthening bilateral trade between India and the East European countries and USSR in the field of electronics. The company was also set up with a view to implementing policies and strategies for facilitating the growth of the electronic industry in India. It acted as the canalising agency for import of various components for computers, consumer electronics and telecommunications under the “ET&T” brand name..

Over a period of time, the product mix of the company has undergone a change and the company is currently engaged in assembling of PCs, software development, marketing of software products and computer education.

The paid up equity share capital of ET&T is Rs. 5 crores which is wholly held by Government of India and the accumulated losses as at 31st March, 1997 amounted to Rs. 56.8 crores.

Industry Analysis

As has been mentioned above, ET&T is primarily engaged in a variety of activities in information technology (IT) industry. The IT industry is currently the fastest growing industry in the economy. The industry has grown from a turnover level of about Rs. 2,700 crores in FY 92 to about Rs. 13,400 crores during FY 97 resulting in a CAGR of 38%. The major segments in the IT industry which contributed to this growth were hardware sales, development of software for domestic and export and computer maintenance. Even though the domestic growth rates have been substantial, India's share in the global IT industry is only 0.7% of the world market as it has to face tough competition from other Asian, European and Latin American countries.

Hardware Segment The share of the sales value of the domestic hardware segment in the total IT industry has declined from 65% in FY 91 to about 30% in FY 97. This segment which was earlier dominated by Indian companies has now seen an increasing market presence of transnational companies with access to state-of-the-art technology. Most of the Indian companies have closed down manufacturing operations and have switched to value-added sales and service.

Software Segment Computer software for domestic use and exports has been a major contributor to the Indian IT industry. Exports from this segment have grown at a compounded annual growth rate (CAGR) of 53% over the past six years i.e., FY 91 to FY 97. The computerisation projects undertaken by various sectors of the economy such as Banking, Insurance, stock market etc. has resulted in the rapid growth of the domestic segment. Moreover, due to the year 2000 date conversion project (Y2K), the Indian software segment is expected to grow significantly over the next few years.

Maintenance Segment As the level of computerisation has grown rapidly, the related service segment also has also grown faster. Computer maintenance is emerging as a major area of operation in the IT industry. Maintenance can be either undertaken by the manufacturers themselves or by third party maintenance. The latter is expected to become popular as has been the case abroad.

Training and Education Segment Another service segment which is growing faster in the IT industry is the training and education segment. Currently the software industry employs approximately 150,000 people and with India emerging as a strong base for the Y2K projects, the requirement of manpower training would increase substantially in the near future. This segment is dominated by two companies, i.e. NIIT and Aptech who together account for 65% share of the market. Tie-ups with leading international companies that are engaged in this business are expected to enhance the value of the training programme. Even many of the international software developing companies are planning to set up their own training and education centres in India.

Business Analysis

ET&T's operations can be organised under six major divisions and the income composition from these divisions for FY 97 is as follows:

Table 1 Composition of Income in ET&T's operation - FY 97

Division	% of Total Income
Equipment Imports & Project Consultancy	44
Information Technology	36
Consumer Electronics	12
Computer Education and Training & Instructional Video	8
TOTAL	100

ET&T derives more than 40% of its total income from the business of importing electronic equipments and project consultancy. The company imports equipments are used in the defence & paramilitary sector, research laboratories apart from equipments used by educational institutions and various Government departments. The company undertakes total service package for the import of equipments.

In the area of project consultancy, ET&T undertakes consultancy in the following:

- Providing consultancy services for cable televisions, closed circuit TV, surveillance systems, video projection system and EPABX systems for defence and Government organisations;
- Marketing security systems like bomb detection and disposal equipment for Police departments and Indian Army; and
- Marketing communication equipments like pagers to the Police and different ministries.

The second contributor in the total income of ET&T is from various IT businesses. The company undertakes assembling of personal computers (PC), marketing computer hardware and its maintenance, software development and marketing of branded software products etc.

ET&T assembles PC at its facility at Bhiwadi, Rajasthan. This unit was initially set up by the Rajasthan Financial Corporation and was acquired by ET&T in 1993. The company assembles PCs with 386, 486 and Pentium chips. However, the number of PCs assembled in this unit has declined sharply due to low level of orders received.

The company's software development activities is located in Gandhinagar in Gujarat. The segment is dominated by large number of players and the share of ET&T is insignificant.

In the consumer electronics division, ET&T assembles colour TVs (CTV) and black & white TVs (B&W TV) from kits and sells them in domestic and overseas markets. The company's production of various types of televisions has been on a decline over a period of time as shown below:

Table 2 Details of Production of Television (Nos)

TV Models	FY 97	FY 96	FY 95	FY 94
14" CTVs	835	4170	8425	17350
14" B&W TVs	247	459	0	0
20"/21" CTVs	83	73	0	0

ET&T is also engaged in computer education and training. ET&T has around 65 franchisees, at different locations in the country, offering short term and long term courses for beginners as well as customised courses for professionals. The company's share when compared with the total size of the segment is insignificant.

The employee strength as at 31st March, 1997 was 333 and about half of the total manpower are clerical. The company has announced a voluntary retirement scheme in May 96, but so far only 6 employees availed this facility.

Financial Analysis

The financial performance of ET&T for the past five years is given below:

Table 3 Financial Performance (Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	45.6	30.1	49.6	63.5	74.0
Operating Profit	-3.2	-3.2	-1.8	0.7	0.5
Profit after Tax	-16.1	-15.0	-12.9	-6.5	-5.8
Equity Capital	5.0	5.0	5.0	5.0	5.0
Tangible Net Worth	-56.8	-40.6	-25.7	-13.5	-6.8

Note: The ratios have not been presented as they are all negative.

The company's operating income has been declining due to its inability to withstand the severe competition. However, with a renewed thrust towards information technology and computer education, the company was able to achieve a growth in turnover in FY 97.

While both sales and margins have declined the company's establishment expenses continued to remain high resulting in increasing operating losses. With funds locked up in inventories and debtors, and cash credit facilities frozen by banks due to defaults, the company borrowed short term loans for working capital purposes, resulting in increasing interest burden. Interest cost as a percentage of total income was 23% in FY 97. Increasing interest burden has resulted in an increasing level of losses during the last three years.

The inventory value as on 31st March, 1997 was Rs.9 crores while the company had provided about Rs.4.7 crores for obsolescence and diminution in value. The overdue position of debtors as at 31st March, 1997 was Rs.11.9 crores while the company has made a provision of Rs. 4.4 crores for doubtful debts.

To cover up the deficit in current operations, ET&T borrowed from a number of sources including banks. The total external liabilities as on March 31, 1997 were Rs. 67 crores. Some of these banks have already started the process of recovery through the Debt Recovery Tribunal.

Strength and Areas of Concern

Strength

Professional Staff: The quality of human resources is a key factor in the IT industry. ET&T has, inspite of its problems, been able to retain qualified professional staff on its rolls.

Areas of Concern

Poor Business Position: The poor business position of ET&T can be attributed to a number of external as well as company related reasons. The decanalisation of imports of electronic equipments by Government in the late eighties and early nineties made ET&T redundant to a large extent. At the same time, the lack of timely steps to adapt to the changing environment caused a sharp decline in the company's turnover.

The company's entry into highly competitive areas such as trading, assembling of PCs, and computer education without any sustainable competitive advantage have seen a rapid erosion in the business position of the company.

Poor Financial Position: With a view to meeting the deficit in current operations, the company resorted to short term borrowings from PSUs and banks without a clear assessment of its own repayment capacity. The short term borrowings were used for financing manufacturing facilities which due to low capacity utilisation turned out to be unviable. With increasing interest burden, the company has become irregular in the payment of dues. The problem has been compounded due to the freezing of working capital loans from banks and financial institutions.

In addition, poor recovery systems have caused accumulation of debtors, major part of which turned bad and have bleak prospects of recovery.

Excess manpower: ET&T's sales turnover has declined substantially and, at the current level of operations, the manpower strength especially on the non-technical side is on the higher side. The company's efforts to reduce manpower levels through a VRS has not been successful.

ET&T's Turnaround Plan

Given the above areas of concern, the company has submitted a restructuring plan for turn around to its Administrative Ministry. The plan comprises of the following:

- One time settlement with the existing banks, PSU lenders to be provided by Government;
- Waiver by Government of its outstanding loans and continuation of ways and means support;
- Reduction of non-technical manpower by 50 and induction of a corresponding number of technical persons;
- Fresh cash infusion of Rs.10 crores by Government;
- Sale of part of fixed assets and
- Refocus business on education and training, software development, IT solutions and Trading. In particular, the focus would on the lower end of the educational and training segment in smaller cities.

According to the company's estimates, if the above plan is implemented, the company would turn around in two years time and would be self sustaining without the need for any budgetary support

Recommendation

The areas of operations of the company viz., consumer electronics and information technology are extremely competitive. The opening up of the consumer electronics industry to imports has led to this increased competitiveness. Domestic as well as international companies are making considerable investments in these segments. Further, in order to retain their competitive advantage, these companies are making continuous efforts at product innovation and are offering attractive packages to draw customers.

India is among the few countries in the world which are globally competitive in the IT industry. As a consequence, the IT industry has matured in terms of investment as well as technological capabilities.

The markets in which ET&T operates are thus fully contestable. ET&T's development objectives as envisaged in the seventies may no longer be as vital in the above scenario. **The Commission has therefore classified ET&T as non-core.**

Given its precarious position, the company has formulated a turnaround plan for financial restructuring which would require waiver of both principal and interest from banks as well as Government. **The Commission has examined the above plan in detail and is of the view that the turnaround prospects have a high element of risk since ET&T faces stiff domestic as well as international competition in its areas of operations. Even if the turnaround is complete, the profits of the company would remain at low levels because of the low margins from its product-mix of operations and high burden of overheads. In such a scenario, it is difficult to envisage investor interest in the operations of the company.**

As a prudent investor, the best option available to Government would be to discontinue all operations. **The Commission therefore recommends that ET&T should discontinue all its operations with immediate effect. However, existing contracts taken on by the company should be completed and no new contracts should be entered into by the company.**

In order to facilitate the discontinuation of operations, the Commission recommends that Government announce a package of measures comprising:

- **A pension-cum-insurance scheme as an alternative to a one-time payment for the employees who are not professionally qualified. An outline of the scheme has already been given by the Commission in its Fourth Report.**
- **Career counselling on alternative available options for employees who are professionally qualified. In such cases, the company should formulate a scheme by which the professional staff could take advantage of other opportunities in the fast growing IT industry.**
- **If some of the employees have entrepreneurial aptitudes, Government should encourage them by providing assistance as suggested by the Commission in its Fifth Report. ET&T has 65 franchisees at different locations in the country which offer short term as well as long term courses for beginners as well as customised courses. If some of the employees are interested in running these franchisee units jointly by forming a corporate enterprise, Government should encourage handing them over after suitable pre-qualifications. In such cases, the lumpsum amounts payable on account of VRS could be adjusted against the value of the assets. Government could, in the initial years, provide some external assistance till the time that business stabilizes.**

At a later point and if required, Government may also appoint Financial Advisers who could assist in the sale of the assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.

2.2 Hindustan Vegetable Oils Corporation Limited

Evolution

Hindustan Vegetable Oils Corporation Limited (HVOCL) was incorporated on March 31, 1984 with the merger of two private sick enterprises i.e. Ganesh Flour Mills Limited (GFM) and Amritsar Oil Works (AOW).

Prior to the nationalisation, Government had taken over the management of these companies under the Industries (Development & Regulation) Act. The performance of the companies even after management intervention was not healthy and subsequently the assets of the company were taken over and merged to create Hindustan Vegetable Oils Corporation in its present form. The company is under the administrative control of the Ministry of Civil Supplies, Consumer Affairs and Public Distribution. The shares of the company are wholly held by Government.

Industry Analysis

The production of vanaspati was HVOCL's primary business in the early 1990s which contributed to more than 50% of the turnover at that point of time. However, due to the general decline in the vanaspati and refining oils industry, Palmolein packaging for the public distribution system and breakfast foods have become the primary activities of the company and account for more than 75% of the total turnover since the last two years.

PDS Packing

Packing of imported refined oils for PDS distribution was started by Government during the late 1970s initially to refine and pack the imported rape seeds and mustard oil. This was done to tide over the edible oil shortage faced by the country during that period. Later, when the country became self-sufficient in rape-seed and mustard oilseed production, Palmolien became the major imported oil during the last decade.

The allocation of oil for PDS packing is done state-wise by the Ministry of Civil Supplies based on demand from states and funds allocated for oil imports. The packing allocation for HVOCL is on the basis of the presence of HVOCL in a state and the extent of its installed capacity.

The company gets a fixed net margin of 3-4% from Government. Since all costs are reimbursed, the company has no incentive to improve production efficiency. Subsequent to the easing of availability of edible oils in the country and the shift to liberalisation of imports, Government has taken a conscious decision to reduce the edible oil imports on its own. As a result, the trend of packing allocation to HVOCL has been volatile during the past five years. Also with the shift of edible oil imports to OGL, oil imports by government are likely to decline further.

In summary, HVOCL faces considerable uncertainty in the scale of its operations due to the variations in allocations by Government from year to year in the PDS packing business.

Breakfast Foods

The breakfast foods industry in India comprises product like corn flakes, oats and museli. All these products are ready-to-eat and are normally consumed with milk. The breakfast foods are consumed more in urban areas where the disposable income is higher and awareness about the benefits is high.

Cornflakes The market size is presently estimated at 4,000 tpa which has quadrupled after the entry of multi-nationals since the early nineties. The three major players in this segment are Kelloggs, Mohan Meakins and HVOCL. Although there is a large market potential due to low penetration and low per capita consumption, the markets have to be built up in terms of brands and distribution networks.

Oats In the oats segment the demand is largely supply driven with demand presently being higher than supply. HVOCL has been so far the dominant player in this segment due to the absence of any large player. When compared with developed markets, the market penetration is again quite low. However, the entry of Quaker Oats (the world's largest oats producer) and the tie-up of ITC-Agro Tech with ConAgra (which is a popular brand in South Asia) is expected to intensify competition and could adversely affect HVOCL's position.

HVOCL markets its cornflakes and oats under a common brand name “Champion” which has been fairly popular because of its long existence. However, given the poor financial position of the company, HVOCL has not made any investment in developing its brand or strengthening the sales network. In fact, the company relies on the Mysore Sales International Limited (a Karnataka State Government Agency) for nation-wide distribution.

The Breakfast foods business of HVOCL is likely to be under threat against the onslaught of MNC’s. Even though the company enjoys a fairly good brand equity, it lacks the marketing, distribution and financial resources to compete against players like Kelloggs and Quaker Oats.

Business Analysis

The company has manufacturing facilities at 8 locations spread all over India with vanaspati manufacturing mainly in Delhi, Kanpur and Amritsar. The packing capacities are located in those states where the allocation of PDS is high. The present status of units is indicated in the following table

Unit	Major Operations	Current Status	Employees
Delhi - V	Vanaspati	Shutdown due to Supreme Court Order	265
Delhi -BF	Breakfast foods and PDS packing	Operational	191
Amritsar	Vanaspati and PDS packing	Vanaspati shut down due to technological obsolescence	282
Kanpur	Vanaspati and PDS packing	Vanaspati shut down due to technological obsolescence	332
Mumbai	Oil refining and PDS packing	Refining shut down due to technological obsolescence and packing operational	346
Calcutta	Oil refining and PDS packing	Operational	31
Chennai	PDS packing	Operational	31
Bangalore	PDS packing	Operational	24

The company has large capacities with obsolete technology in vanaspati and refining. Production at two vanaspati units (Amritsar, Kanpur) and oil refining units (Mumbai, Amritsar and Kanpur) has been stopped due to obsolete technology leading to high cost of production and poor product quality. Manufacturing operations at Delhi vanaspati and Calcutta (refining) units have been stopped as per court orders.

Old plant and machinery is primarily responsible for the low capacity utilisation in the breakfast foods division. The company has stopped the production of wheat-flakes due to poor market response. Corn-flakes production has been curtailed due to strong competition from Kelloggs, Mohan Meakins, and Gold Crunch. Oats production has not increased despite market demand due to operational problems in the pneumatic machines which were installed after a fire destroyed the oats production line in 1991.

In the case of PDS packing, the utilisation of packing capacities is dependent upon the packing allocation by Government to HVOCL and hence it has no control over the capacity utilisation in this segment.

The oil refining and vanaspati production are economically unviable as the sales realisations do not cover even the variable costs. While the material costs are higher due to the absence of efficient procurement systems, the power and fuel costs are higher due to lower efficiency as compared to industry norms.

The primary raw materials in the manufacture of vanaspati are crude edible oils like soyabean oil, cottonseed oil, sunflower oil, mustard oil (solvent extracted), rice bran oil, sesame oil, etc. The vanaspati units of Amritsar and Kanpur are located in the oil seed growing areas of Punjab (cottonseed) and Uttar Pradesh (mustard). Besides, oil seeds like soyabean / mustard are also crushed in neighbouring states of Madhya Pradesh and Rajasthan. Since the prices of oils vary on a day-to-day basis, it is extremely important for a company to have proper systems to monitor oil prices on a daily basis so as to buy oil when prices are low and monitor quantum of oil requirements. In this respect, HVOCL is placed at a disadvantageous position, as the company is not always able to take quick decisions due to its PSU character.

HVOCL lacks logistical abilities and qualified man power required for efficient sales and marketing functions.

Financial Analysis

The financial performance of the company for the last five years is shown in the table below:

Table 2 Financial Performance (Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	113.0	98.3	93.5	87.8	146.3
Operating Profit	-2.5	-3.9	-6.0	-7.4	-2.3
Profit after Tax	-2.5	-3.8	-7.1	-10.3	-3.8
Equity Capital	7.7	7.7	7.7	7.7	7.7
Tangible Networth	22.5	24.3	29.9	38.4	49.7

Note: Ratios have not been presented as they are all negative

The operating income decreased by 40% in FY 94 mainly due to decline in vanaspati and packing business but has since increased due to increased packing allocation.

The company has been incurring continuous losses for the last six years which has eroded its net worth from the level of Rs. 50.22 crores in FY 91 to Rs. 22.5 crores as on March 31, 1997. The losses are mainly due to closure of its main businesses while the fixed expenses have remained more or less constant. In addition, the company has incurred an expenditure of Rs. 9.5 crores (out of which of Rs. 7.11 crores was received from NRF) on account of VRS started in FY 91. It is likely to incur expenditure on this account in future also.

The company has an unsecured loan of Rs. 3.5 crores from Government, on which interest has been due for the last six years. The principal cum interest liability has grown to a high of Rs. 8.07 crores as on March 31, 1997.

Strengths and Areas of Concern

Strengths

Hidden Assets The company's operations in Delhi and other metro cities are located in the heart of the cities. The land on which factories exist have significant real estate potential.

Good Brand Equity HVOCL has brands such as "Champion" which have been in the market for a fairly long time. As a result, the brand equity of some of the products is fairly high.

Areas of Concern

Low Margin Businesses The existing businesses of HVOCL which is PDS packing and breakfast foods have inherently low margins. As a result, the company has not been able to build a strong financial position.

Obsolete Technology The company's vanaspathi units have been closed down due to obsolete technology. As a result, the staff at these units have become idle which has added to the operational costs.

Commodity Nature of Business: HVOCL operates in agro-based commodities for inputs which require strong procurement skills to maximise profits. Being a PSU, it is difficult for the company to take quick business decisions.

Poor Marketing The processed foods business world wide is brand driven. Companies with financial resources who can build up brands in the initial years have built sustainable competitive advantages in the long term. In this respect, the poor financial position of HVOCL has placed the marketing of the company's products at a disadvantage. The company has not been able to match the marketing strategies of multi-nationals who have entered India.

Recommendation

The Commission classifies HVOCL as non-core due to two reasons:

- The reasons for HVOCL's nationalisation - Government control of the vanaspathi industry- is no longer relevant in today's context of free edible oil imports and alternative availability of edible oils. In addition, the segment is highly competitive due to the presence of a large number of players.

- The breakfast foods business has seen the entry of a number of multinational companies which has increased the level of competition in the industry.

The markets in all the business segments in which HVOCL operates are thus highly contestable and no public purpose will be served by sustaining a loss making public sector company in the processed foods business requiring quick decisions for viability.

As far as the vanaspati business is concerned, the Commission has noted that two of the units located in Delhi and Calcutta have been closed down by a Supreme Court order. The relocation of the plant and machinery and subsequent revival is unlikely given the fact that the plant and machinery have remained idle for more than five years. As far as these units are concerned the Commission recommends that Government should implement the Hon'able Court's decision in toto and compensation paid as per the Court directives.

In respect of vanaspati and refining units in other locations, revival is highly doubtful given the obsolete technology and the dilapidated condition of plant and machinery. Besides, with HVOCL's networth already eroded by about 60% over the last five years, the company is in effect on the verge of becoming sick.

As far as the packing business for PDS is concerned, the Commission has noted that the net margins provided by Government is in fact an indirect subsidy which has sustained the expenses in the other unviable operations. This business has an uncertain future as the allocations by Government - which have been volatile in the past - are likely to decline significantly in the future.

In such a scenario, the Commission recommends that the company's operations in vanaspati and packaging of refined oils be discontinued with immediate effect.

Prior to such discontinuation, the Commission recommends that Government should announce a package for the employees. The scheme should cover the following:

- **A pension-cum-insurance scheme in lieu of a one-time payment for voluntary separation for the employees based on the last salary drawn. An outline of the scheme has already been given by the Commission in its Fourth Report and is reproduced in Annexure 1. The employees covered under the Supreme Court order should be excluded from this scheme.**
- **Career counselling on alternative available options. If the level of skills developed by an employee is high, Government should actively assist the employee in finding alternate jobs in the private sector**

- **Those employees having entrepreneurial skills, should be encouraged by providing assistance as suggested by the Commission in its Fifth Report such as making available counselling services in collaboration with organisations like the Industrial and Technical Consultancy Organisations in each State and regarding alternative investment options like establishing small business ventures or retraining for alternate employment.**

The breakfast foods business has been running with a well established brandname especially in the oatmeal segment. All over the world, the processed foods is brand driven and requires a strong level of financial support to develop and create new markets. With increasing globalisation of the Indian economy, the markets in India are unlikely to be different. In such a scenario, the strengthening of the business will require significant funds as well as managerial inputs which is lacking in HVOCL. **The Commission therefore recommends hiving off the breakfast food business into a new company and subsequent sale of 100% holding through a competitive bidding process.**

The estimated value of the other freehold real estates owned by HVOCL units (as per the valuation performed by Central Bureau of Direct Taxes (CBDT) in November, 1996) is quite substantial. Hence the net inflow to Government by closing down all the units by liquidating their assets and selling the breakfast foods unit after settling all the claims and retirement benefits would still be high.

At a later point in time, Government may also appoint Financial Advisers who could assist in the sale of the demerged assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.

2.3 Hindustan Zinc Limited

Evolution

Zinc mining and purification has been carried out in India for several centuries with the mining industry preceding the smelting industry. The zinc industry was consolidated into Hindustan Zinc Limited (HZL) after the nationalisation of various zinc mines. HZL, is engaged in the business of mining and smelting zinc and lead. While the mining reserves are located in Rajasthan, the smelting capacities are located in Rajasthan, Andhra Pradesh and Bihar.

The equity capital of the company as at 31st March, 1997 was Rs. 423 crores. The Government of India has so far disinvested 24% of its holding. The current shareholding pattern of HZL is as follows:

Table 1 Share Holding Pattern

Name of share holder	Percentage
Government of India	76
Financial Institutions	21
Public	3
TOTAL	100

The shares of HZL are listed at Bombay Stock Exchange and is currently trading at Rs. 15.25 as on December 26, 1997.

Industry Analysis - Zinc

Zinc is an ancient metal which co-exists with a number of other metals like copper, lead, silver and cadmium. The industry can be divided into two distinct components - mining and smelting. The mining industry excavates the ore from surface or underground deposits (which contain metal content typically between 2% to 15%) and beneficiates the ore to produce concentrates with 50-55% metal content. The smelting industry converts the concentrate into high purity zinc metal. The smelting operation for zinc can be based on either an electrolytic or a pyrometallurgical process.

Globally, the known reserves of zinc metal are around 330 million tonnes with annual consumption being around 7.3 million tonnes. The Indian reserves are estimated at 20 million tonnes with annual domestic consumption being about 200,000 tonnes. The global geographical dispersion of the industry in terms of major mining, smelting and consumption countries is given below:

Table 2 Global Zinc production, consumption (Million tonnes)

Name of the Country	Ore Production	Smelting	Consumption
Canada	1.00	0.69	0.14
Australia	0.97	0.32	0.16
China	0.75	0.97	0.57
Peru	0.67	0.15	0.54
USA	0.58	0.35	1.17
Japan	0.10	0.66	0.73
CIS countries	0.35	0.37	0.29
Germany	-	0.36	0.51

From the above table, it can be seen that Canada, Australia and China account for approximately 41% of the world ore production while China, Canada, Japan and Germany account for 40% of the smelting capacity. In terms of consumption, USA, Japan, Germany and China account for around 45%. Asia has become a principal consumption market accounting for approximately 37% in FY 96 as against only 6% in FY 60.

Historically, India has been self-sufficient in zinc. Currently however, India is a net importer of both zinc metal and concentrate. The latter is primarily imported by Binani Zinc, a private sector producer which is located near a port.

The Indian zinc industry comprises one integrated producer (HZL) and one smelting company (Binani Zinc) with several other secondary zinc producers through the scrap recovery route. The consumption of primary zinc during FY 97 was about 216,000 tonnes as against production of about 140,000 tonnes, with the balance being met out of imports. Apart from the primary zinc, about 30,000 tonnes of secondary zinc was also consumed during FY 97. The domestic production of secondary zinc was almost equivalent to the domestic consumption.

Zinc is primarily used in galvanisation which accounts for 49% of the total world's consumption. Construction and transport sectors are the major end user segments for the zinc accounting for 48% and 23% of the total consumption respectively. The application of zinc could vary from country to country as seen in the following table:

Table 3 Major Consumption Sectors

Region	Application Area	Consumption Sectors
Global	Galvanisation - 46% Die Casting and alloys - 39%	Construction Transport
India	Galvanisation - 70% Die Casting and alloys - 10%	Construction Transport

Since galvanisation is the core application, zinc consumption centres tend to be co-located with steel product manufacturing locations. While globally, the traditional application area for housing has been experiencing low growth rates, in emerging economies like India and China, steady growth in consumption is expected. However, zinc consumption is threatened by substitutes like plastic coatings etc.

Industry Analysis - Lead

The lead industry co-exists with the zinc industry for the following reasons:

- Several ores contain lead in significant proportion with zinc;
- In the pyro-metallurgical route, zinc and lead can be produced simultaneously and
- London Metal Exchange (LME) is the nodal agency for trade in both the metals

Lead metal production world wide is around 5.2 million tonnes per year with the consumption fluctuating significantly. The major consumption areas for lead is the storage battery industry which traditionally accounts for about two thirds of the consumption.

In India, HZL in the public sector and India Lead Limited (ILL) in the private sector are the two main producers who produce lead through the primary route with capacities of 65,000 tonnes per annum and 24,000 tonnes per annum respectively. Apart from these two producers, there are many small companies who operate through the secondary route..

The lead production in FY 97 was 43,433 tonnes while consumption was 84,000 tonnes. This increase in consumption has been driven by a corresponding increase in the market for automotive and industrial batteries. India is a net importer of lead, even though a substantial part of the requirement is met by the secondary sector.

LME is the nodal exchange for international trade in metal and concentrates. The prices of both zinc and lead are determined on the basis of LME prices. As mentioned above, Asia is emerging as a major production and consumption centre for zinc. China being the dominant player on the LME, China influences LME zinc prices. HZL is not registered on the LME and India is represented through Binani Zinc and India Lead.

Business Analysis

HZL has a dominant position in the zinc and lead mining industry in India. The total ore reserves in HZL's leasehold area are estimated to be 122.7 million tonnes. In addition, the company has rights to about 40 million tonnes of possible reserves. The details of HZL's reserves are given below:

Table 4 Details of HZL's Zinc Lead reserves (Million Tonnes)

Sl.No	State/Mine	Reserve(*)	% Lead	% zinc
Rajasthan				
1	Zawar Group	36.51	2.02	4.66
2	Rajpura Dariba Group	29.07	2.39	7.31
3	Rampura Agucha	48.25	1.98	13.53
4	Ghughra	5.52	1.88	3.35
Orissa				
5	Sarigapalli	1.48	5.49	0
Andhra Pradesh				
6	Agnigundala	1.85	5.46	0
Total (**)		122.67	2.19	8.59

(*) Reserves include developed probable

(**) In addition to total reserves indicated, additional 40 million tonnes of possible ore reserves exist in HZL lease hold areas

The Rampura Agucha mine is an open cast mine and has the highest quality of ore among all HZL mines. This mine operates at internationally comparable norms and at competitive costs. The cost of mining and milling concentrate varies considerably in HZL's mines. The average cost of mining and milling of concentrate for HZL mines is around Rs.7,003 per tonne.

HZL owns 4 smelters with metal processing capacity of 214,000 tonnes per annum. It has a zinc smelting capacity of 149,000 tonnes per annum and lead smelting capacity of 65,000 tonnes per annum. HZL's smelters - located at three locations - employ different technologies and the efficiencies of these smelters varied differently. The performance of different smelters are as follows:

Table 5 Performance comparison of HZL smelters (FY 96)

Particulars	Debari	Vizag	Chandaria
Year of Commissioning	1968	1977	1991
Technology	Electrolytic	Electrolytic	ISP*
Zinc Recovery (%) - Actual	93	88	83
- Possible	95	95	91
Installed Capacity - Zinc (Tonnes)	49000	30000	70000
Capacity Utilisation (%)	105	93	51
Installed Capacity - lead (Tonnes)	Nil	35000	22000
Manpower	1655	1642	843

(*) Imperial Smelting Process

Debari is the oldest zinc smelter of HZL and is the best among the smelters of HZL in terms of recovery percentage and capacity utilisation. The Vizag smelter being a port based smelter was set up with an objective to process imported concentrate. However, after the development of Rampura Agucha mines, this smelter started using the concentrate from the captive sources. The transportation cost of concentrate from Rajasthan to Vizag makes the conversion cost per tonne of metal from this smelter significantly higher.

HZL set up its third smelter at Chanderia using Imperial Smelting Process (ISP) technology which was a new technology. In terms of manpower, this smelter uses lower levels of manpower even for a higher capacity. The smelter operates with 83% zinc recovery and about 51% capacity utilisation. The smelter has high expenditure on stores, spares, components and consumables. The ISP technology used in the plant has been used only in 14 plants worldover and only two plants in Japan are operating satisfactorily after modification. HZL is hopeful that the capacity utilisation of the smelter would improve substantially over next two years and would result in improved profitability.

The average conversion cost of HZL is Rs.25,190 per tonne which is significantly higher than international conversion cost of Rs.13,500 to Rs.15,500 per tonne. One of the reasons for this higher cost is the size of smelters of HZL. Worldover, smelters have capacities much greater than the Chanderia smelter.

Future Plans

HZL has entered into an agreement with BHP Ltd, an Australian based mining company to undertake aerial survey and exploration over a stretch of 15,000 sq.kms in Rajasthan. Apart from this, the company has plans to incur about Rs. 1350 crores on various capital expenditure schemes during Ninth Five Year Plan period:

- Plan to expand the Rampura-Agucha mine at a cost of Rs. 60 crores
- Plan to invest in a new zinc smelter at a cost of Rs.475 crores and Rs.80 crores for expansion of capacity at Debari and Vizag
- Plan to invest Rs. 430 crores in a power plant for captive consumption
- Rs.40 crores to be invested in joint ventures
- Rs. 70 crores to be spent on diversification into other metals etc.
- Rs. 145 crores towards replacement of plant and machinery

Financial Analysis

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

Table 6 Financial Performance (Rs.Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	823.3	972.7	759.8	777.8	702.2
Operating Profit	175	181	126	210	199
Profit after Tax	42.4	76.4	4.6	62.9	93.4
Equity Capital	422.5	422.5	422.5	412.5	403.7
Tangible Networth	821.7	777.9	643.4	669.7	636.3
Gross Margin (%)	21.3	18.6	16.6	27.0	28.3
Net Margin (%)	5.1	7.8	0.7	8.1	13.2
ROCE (%)	10.6	11.6	6.7	10.9	13.0
RONW(%)	5.1	9.8	0.8	9.4	14.6
Earnings per Share (Rs.)	1.00	1.80	0.11	1.52	2.30
Dividend (%)	2.0	-	-	6.0	6.0

Sales value increased from Rs.700 crores in FY 92 to Rs. 973 crores during FY 95 primarily due to increased sales volume as the prices of zinc concentrate and metal fluctuated during the period. HZL's realisation came down as a result of sales price rationalisation in line with international prices. The gross margins showed wide fluctuations from a level of 28% in FY 92 to 21% in FY 96. One of the reasons for the fall in margins can be attributed to the lower operational efficiency of Chanderia smelter. Net margins have shown significant fluctuation and the fall in margins is due to lower realisation and increase in interest outflow.

Power is an important element in the total cost of production. The cost of power is significantly high when compared with smelters in other countries which results in higher cost of production. The company is planning to meet its power requirement by setting up a captive power plant.

Strengths and Areas of Concern

Strengths

Dominant producer HZL is the only integrated producer of both zinc and lead in the country with 55 - 60% market share. The company enjoys a dominant status both in the mining and the smelter segment. This has enabled them to influence prices in Indian market to some extent even though the company is not a member of LME.

High quality ore The company reserves of international grade ore in the Rampura-Agucha mines are among the best in the world in terms of average metal content.

Bright Growth Prospects The widening demand supply gap and increasing demand scenario will enable HZL to grow in the medium term. It is estimated that the consumption of zinc will grow at a CAGR of 6-8% while the lead consumption is expected to grow at a CAGR of 6-7%. The demand supply gap for zinc is expected to be 50% by year 2000.

Areas of Concern

High cost of production The average conversion cost for HZL is higher when compared with the international norms. This puts HZL in a disadvantageous position. Similarly, the average metal production cost of HZL (excluding head office overheads and sales overheads) is almost close to the landed price of imported Zinc thus leaving no margin for HZL.

Reduction in import duty Existing level of import duty provides substantial protection to HZL. However, a further reduction in the custom duties together with a fall in LME prices can put further pressures on HZL's margins.

Power cost and availability Rajasthan is a net power deficit state and has to depend on power from other States. Because of this, the cost of purchased power for HZL is high and the availability is also at times difficult.

Water Shortage The smelting process of HZL requires extensive water and Rajasthan is also a water deficit state. HZL has to incur expenditure to meet the water requirement by setting up dams.

Smelter capacity and utilisation The installed capacity as well as the capacity utilisation for the existing smelting plants is relatively low when compared with global smelters. This has led to increased cost.

Recommendation

While the company has been categorised as a “non-core” PSU by the Commission, having regard to its dominant market share in the Zinc industry and also its considerable ore reserves, the Commission would not recommend disinvestment in the company beyond 49% at present. Also taking into account the reserves of high grade Zinc ores in the country, continued Government control over this company may be desirable to conserve this exhaustible material for the downstream industry and safeguard against indiscriminate “slaughter mining” for short-term financial gains. **No public purpose will be served by converting a near public monopoly to a private monopoly and therefore disinvestment beyond 49% is not considered desirable at present. This issue can be reviewed once the situation changes in the future.**

The Commission, therefore, recommends that the Board of the company be given managerial autonomy (on the lines of the Strong Performer as categorised by the Commission in its First Report) with due regard to its successful track record of profitability and dividend pay-out to enable it to implement its projects of diversification relating to:

- **establishing joint ventures for exploration of further reserves;**
- **establishing captive power plant and**
- **expanding and developing mines for production of high grade zinc ore.**

HZL may scan the market for a suitable strategic partner who may be offered upto 25% of the equity stake in the Company alongwith appropriate role in the management. Such a partner should be able to add to HZL's strengths in terms of mining and production management, technology and access to international funds and markets. A strategic partner in HZL will also be willing to pay higher price for a stake in the company and Government proceeds could thus be maximised.

If this option is not feasible, Government could consider disinvestment upto 25% in one or more tranches in the domestic market with preferential allotment to small investors and the employees, as set out in the Commission's First Report.

2.4 Hotel Corporation of India Limited

Evolution

Hotel Corporation of India Limited (HCIL) was set up as a 100% subsidiary of Air India (AI) in 1971 with the objective of catering to the requirements of AI in respect of hotel rooms for its transit passengers and crew. The flight catering division of AI was merged with HCIL. In 1975, HCIL set up the Centaur Hotel in Mumbai. The Centaur Delhi was set up in 1982, while the Centaur Lake View Hotel in Srinagar was established in 1983. Later in 1986, to meet the growing tourist traffic demand, the Centaur, Juhu was set up.

There has been no disinvestment in HCIL and the entire equity of Rs. 40.6 Crores are held by AI.

Industry Analysis

The hotel industry is the second largest foreign exchange earner in the country and is one of the most important elements of infrastructure for tourism. The hotel industry can be divided into various segments for meeting the requirements of different classes of tourists. The five star hotel industry (Elite segment) can be further categorised into business hotels located in metropolitan cities and business cities and tourist hotels located in places of tourist interest.

The total room capacity in five star and five star deluxe category in India is 18,025 out of which about 62% are located in four metropolitan cities. Out of the total rooms available, 51% are in Delhi and Mumbai, which makes these two cities the largest business centres. This segment of hotel industry is dominated by private sector companies. East India Hotels Ltd. (Oberoi group) manages 10 hotels throughout the country while Indian Hotel Co.Ltd.(Taj group) manages 14 hotels. In Mumbai, 70% of the room capacity is accounted by Taj group, Oberoi group, Hotel Leela Kempenski. In Delhi, this is more evenly distributed across different players such as ITC group, Taj group, Oberoi group, Asian Hotels Ltd, Bharat Hotels Ltd. etc.

The opening up of the economy has resulted in an annualised growth rate of 18% in business traveller traffic between FY 93 and FY 96. The conservative estimate of growth of business travel over the next three years is 12-14%. The supply demand position of rooms in the two major cities shows that no capacity addition has taken place since FY 94. This has resulted in increased tariff by 30-40% between FY 93 and FY 96, while maintaining a high occupancy level of 70-80%. The room availability and demand forecast for rooms in the two metros for the next four years are as follows:

Table 1 Demand Forecast in Mumbai and Delhi

Mumbai	FY 97	FY 98	FY 99	FY 2000
Room Availability (nos.)	2452	2452	2452	2762
Demand	1716	1922	2153	2584
Av.Occupancy Levels	70%	78%	88%	94%
Delhi				
Room Availability (nos.)	4329	4529	5029	5029
Demand	2814	3151	3530	3954
Av.Occupancy Levels	65%	70%	70%	79%

The key success factors for hotel industry are the proximity to business centres, airports and the range of facilities offered. The expected industry growth in business travel segment is 12-14% over the next three years while the expected tariff increase during the same period is only 15-18%.

Flight Catering

This service industry is relatively small in size when compared with the hotel industry and is dominated by the flight catering unit of HCIL in the public sector and the Taj Air Caterers, Oberoi Flight Catering and Ambassador Sky Chef in the private sector. The quality of supplies and reliability of delivery schedule are critical for the success in the industry. The first in the industry to start operations was HCIL. The other three players entered the field in the mid-eighties. The strong bargaining power of the airlines and the smaller size of the market resulted in undercutting of prices which in turn culminated in losses. The entry of private airlines has additionally intensified the competition among the four players. In the last three years, some of the catering operators have also entered into alliances with international airlines in order to improve their bargaining powers and to ensure guaranteed offtake levels.

Business Analysis

The location of HCIL's hotels are shown in the table below:

Table 2 Principal businesses and their locations (FY 97)

Hotels	Location	Category	Rooms
Centaur Airport	Mumbai	5 star	288
Centaur Juhu	Mumbai	5 star Deluxe	372
Centaur Delhi	Delhi	5 star	376
Centaur Lake View	Srinagar	5 star	249
Indo Hokke (Subsidiary)	Bihar	Budget	26
The flight catering services consisting of Chefair and Dining Services are located in Delhi and Mumbai.			

In spite of poor standards of hotels facilities relative to the industry, the supply shortfall in Mumbai and Delhi has enabled the units to increase tariffs while maintaining high occupancies.

The proximity to the domestic airports ensures high level of occupancies from the airline segment in Centaur Mumbai. It is the only unit of HCIL to show consistent profits since inception. Out of 288 rooms, 100 rooms are reserved for AI's transit passengers. The average room occupancy from airlines business contributed 51% while its contribution to total income is only 35%. This is because of the nature of this segment which is highly discounted. The two most remunerative segments are Foreign Free Individual Traveller (FFIT) and Domestic Free Individual Traveller (DFIT). FFIT contributes only 18% to the occupancy while its contribution to total income is 28%. Similarly, DFIT's share in occupancy is only 18% while its share in total income is 24%.

The Centaur Juhu Beach is ideally located in a popular tourist spot. It is the only unit of HCIL which is located on free hold land while all other hotels are on leasehold lands from Airport Authority of India. In the case of Srinagar, the land belongs to J& K Government. Centaur Juhu was incurring losses till FY 93 and has improved its operating performance since then like the Centaur Airport Mumbai. The Centaur Juhu also having a higher room occupancy rate from airlines. The business from airlines contributes 46% of the room occupancy while its contribution to total income is only 32%. The most lucrative segment's (both FFIT & DFIT) contribution in the occupancy rate is 31% with their share in income of 44%.

Centaur Delhi is located close to airport. However, its location is not as advantageous as the Mumbai hotels of HCIL. In Delhi, the airlines business contributes 73% of the total occupancy while the travel segment contributes the balance 27%.

The Centaur Lake View Hotel, Srinagar was set up in 1983. This unit has been incurring operating losses since inception. This unit caters to non regular segments like Border Security Force personnel, officers of banks etc. The tariff charged are significantly low. This is the only big hotel presently operating in Srinagar as all other hotels have been closed down due to political and social instability.

The hotel industry is a highly competitive industry where quality of service is the key success factor. HCIL faces tough competition from the private sector operators. The following table shows the competitive position of HCIL vis-à-vis with other private sector companies who are operating in similar locations close to airports.

Table 4 Competitive Position of HCIL (FY 97)

	Occ. %	ARR (Rs.)	F&B/RR (%)	No of Emp./Room
Centaur Airport, Mumbai	89	2754	24	2.7:1
Centaur Juhu	76	2774	38	2.2:1
Centaur Delhi	65	1888	25	2.1:1
Leela Kempinski, Mumbai	84	5783	46	2.8:1
Taj Palace	74	4771	64	3.0:1

ARR: Average Room Rent; F&B: Food & Beverages; RR: Room Rent

The poor condition of facilities has adversely affected the brand image of Centaur and forced the hotels to compete in terms of price rather than quality. Also a comparison of employee to room ratio indicates that overstaffing does not exist. However, HCIL compares poorly in terms of cost of repairs per room, selling expenses per room, etc.

As mentioned above, the flight catering industry is small with only 4 operators. The private sector operators have already turned around their business while HCIL's units at Mumbai and Delhi are still incurring losses. More than 95% of the meals made by HCIL's catering units are catered to passengers of AI/IA. Due to poor quality and unreliable delivery schedules, the offtake from these two units is progressively declining. The capacity utilisation of both units is low, in the region of 20-40%. HCIL also suffers cost disadvantage when compared with their peers from the private sector. The units are highly overstaffed in relation to the size of their operations. Currently, the unit at Mumbai caters to 40% of the requirements of AI and IA whereas the unit at Delhi caters to only 20% of AI/IA's requirements.

Financial Analysis

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

Table 5 Financial Performance (Rs.Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	118.31	83.67	63.04	53.24	45.73
Operating Profit	45.59	23.14	9.58	3.23	3.24
Profit after Tax	33.92	4.53	-7.44	-13.63	-12.11
Equity Capital	40.60	40.60	40.60	40.60	40.60
Tangible Networkth	7.19	-39.10	-43.74	-36.01	-21.67
Gross Margin (%)	38.5	27.7	15.2	6.1	7.1
Net Margin (%)	28.7	5.4	-11.8	-25.6	-26.5

Note: Other Ratios have not been presented as they are negative

The financial performance of HCIL has improved significantly since FY 94 and the company's network has been positive as on March 31, 1996. Operating margins showed a significant jump from a level of 15.2% in FY 94 to 38.5% in FY 96.

This improved performance has been mainly due to a sharp increase in the average room rent during the last three years. This coupled with a re-scheduling of loans has helped HCIL to turn around and report profits. In terms of unit wise contributions, the Centaur Mumbai has the highest contribution followed by the Centaur in Delhi and Juhu. The Srinagar hotel has a negative contribution.

In the past, loans on all units with the exception of Centaur Srinagar were renegotiated and financial institutions waived penal interest to the extent of 12 crores. HCIL is presently negotiating with SBI for a waiver of penal interest of approx. Rs.17.6 crores and for a moratorium on loans outstanding against the unit amounting to Rs.10.7 crores.

The liquidity position of the company was affected seriously during FY 97 due to delayed payments from AI. In spite of clearing past dues, the outstanding amount of receivables from AI is high at Rs.25 crores as on March 1997.

Strengths and Areas of Concern

Strengths

Assured Business As a subsidiary of AI, the transit passengers and crew business is with HCIL. The company has managed to secure business from other airlines also.

Location The locations of all the hotels of HCIL are good from the point of view of tourism. The Delhi and Mumbai Centaur hotels are located in close proximity to the airports. The Centaur Juhu is also located on Juhu beach which is a popular tourist spot.

Areas of Concern

Poor Brand equity The poor condition of facilities has adversely affected brand image. As a consequence, the company is not able to charge premium on room rents in spite of premium locations.

Low Occupancy Rate When compared with other private sector hotels, the occupancy rates of HCIL hotels are low. Moreover, the occupancy rate is characterised by a high share of business from airlines which operates on substantial discount as compared with the regular tourist traffic.

No proper upkeep resulting in costly renovation All the hotels under HCIL require renovations on a large scale. This will involve significant capital expenditure.

Recommendation

The Commission in its Report V had clarified that disinvestment of shares in a subsidiary company of a PSU would be decided by the Board of Management of the concerned PSU and in future it would not be referred to the Commission. However, where subsidiaries have already been referred to the Commission and where studies have been completed with a view to examining them for the purpose of disinvestment, the Commission would be making recommendation in those cases even if proceeds from disinvestment of shares by the holding companies may not accrue directly to Government. In accordance with this decision, the Commission is giving its recommendations in this case.

HCIL is a subsidiary of Air India and is engaged in two activities viz., managing hotels and flight catering service. Both these businesses requires high quality service and are highly competitive in nature. The private sector presence in both these businesses is significantly high and increasing.

Keeping in view the nature of business in which HCIL is engaged, **the Commission recommends that hotels at Mumbai and Delhi may be sold as separate units through a transparent and competitive bidding process after undertaking a proper valuation through a Financial Advisor. In case of the Centaur, Srinagar, the management of AI could initiate dialogue with J & K Government in order to exit from the ownership of the hotel.** Since lands on which the airport hotels are located belong to the Airport Authority of India, AI would need to negotiate and settle the terms of transfer with them prior to the sale.

AI would have to decide whether the flight catering service should continue to be provided by HCIL or whether it should be sold of as independent units through a transparent competitive bidding process after undertaking a proper valuation by the Financial Advisor.

2.5 National Hydroelectric Power Corporation Limited

Evolution

National Hydroelectric Power Corporation Limited (NHPC) was incorporated as a Government of India Undertaking on 7th November, 1975 with the main objectives of planning, developing, investigating, constructing and promoting hydroelectric power projects in the Central Sector. After the incorporation of NHPC, three on-going projects, which were being executed by erstwhile Central Hydroelectric Project Control Board (CHPCB) under the then Ministry of Irrigation & Power viz. Loktak Project in Manipur, Baira Siul Project in Himachal Pradesh and Salal Project Stage-I in Jammu & Kashmir, were handed over to NHPC between 1977 and 1978 as there were certain problems in continuing their construction through the Control Board. Along with the projects, the entire manpower was also handed over to NHPC.

To fulfill its mission, NHPC has identified the following corporate objectives:

- to execute hydro power projects and achieve capacity additions expeditiously and economically by adopting modern technology and management techniques and integrated project management systems;
- to generate internal resources to meet requirements of funds for construction, operation and debt servicing to the maximum possible extent;
- to ensure optimum utilisation of installed capacity to achieve maximum generation and machine availability;
- to modernise, renovate and uprate its generation units, as well as of other utilities on request;
- to adopt an environmentally conscious and benign approach in building hydro power projects and assessing the positive and negative impact of hydro development on the environment and ecology;
- to undertake consultancy assignments in all aspects of hydro development including execution of work on a contract or on deposit work basis and
- to attain self reliance and self sufficiency on fiscal and technical matters and achieve all round excellence in execution, operation and engineering.

The paid up share capital of NHPC as at 31st March, 1997 was Rs.2917 crores all of which is held by Government of India.

Industry Analysis

Power plays a vital role in the development of any economy. The country's power position has improved substantially over the past five decades from an installed capacity of 1,362 MW in the pre-independence era to 83,288 MW as on March 31, 1996. The country currently has all the three modes of power generation viz., hydro, thermal and nuclear. The power generating utilities are mainly owned by Central and State Governments with a small number in the private sector. A major share of the generating capacities is owned by State Governments. State Electricity Boards (SEBs) are responsible for generation, transmission and distribution of electricity within the State. The Central power generating utilities generate power and sell it to the SEBs. The current installed generating capacities from all the three modes are given below:

Table 1 Installed Generating capacities in Utilities as on 31.3.96

	Hydro		Thermal		Nuclear		Total	
	MW	% Share	MW	% Share	MW	% Share	MW	% Share
State	18603	88.7	34917	58.1	-	-	53520	64.25
Centre	1929	9.2	22069	36.7	2225	100	26223	31.50
Private	444	2.1	3101	5.2	-	-	3545	4.25
Total	20976	100	60087	100	2225	100	83288	100

From the above table, it is clear that out of the total capacity available in the country, the power generating capacity through hydel sources is only 25%. Out of this, 89% are owned by State Governments with Central generating companies owning only 9%. Currently, NHPC is one of the major Central hydro generating company in operation. There are two more Central public sector companies which are setting up hydel power generating capacities viz. The Naphtha Jakhri Power Corporation and Tehri Hydro-electric Development Corporation. Apart from these, Tata Electric Company is also generating power from hydel sources.

India has significant potential for hydel power with its wealth of river sources. The Himalayan river systems lend themselves to run-of-the-river development with relatively small storage, although large storage hydro projects are also possible. The peninsular river systems though suffering from wide fluctuations in seasonal and annual discharges, are still ideal for large storage developments. The regional output potential of hydro projects (at 60% PLF) is yet to be exploited as given below:

Table 2 Regional Potential of Hydro Projects (at 60% PLF) (MW)

Region	Potential Capacities	Developed Capacities	Under Development Capacities	Balance potential capacities	Balance (as a % of potential)
North-Eastern	31857	324	306	31226	98
Northern	30155	4313	2422	23420	78
Southern	10763	5297	1105	4361	40
Western	5679	1814	1531	2333	41
Eastern	5590	7	711	4871	87
<i>All India</i>	<i>84044</i>	<i>12665</i>	<i>6077</i>	<i>65301</i>	<i>78</i>

In countries which have developed power through a thermal and hydel mix, the optimal output ratio between the two has been in the region of 60:40. This ratio is also applicable in India too. It is also suggested that while thermal and nuclear would supply the base load requirement, hydel and gas power would be the source for peak load requirements. This is because hydel and gas based generating plants have the flexibility of instantly increasing/reducing power generation as per the requirements. Despite this, India's hydro power capacity expansion is on slow track. The share of hydro power generation capacity has decreased from 49% in 1950 to about 25% in FY 96. The planned hydro capacity addition during the Eighth Plan period was 9282 MW, but only around 2600 MW was actually added.

The gestation period of a typical hydro electric power plant varies between 6-8 years, while the gestation periods in the case of thermal and gas plants are 4-5 years and around 3 years respectively. Two major reasons for such long gestation periods for a hydro electric project are :

- Uncertainties associated with the geological and topographical constraints
- Socio-economic and environmental problems due to one time submergence and flooding of vast areas and need for rehabilitation of the displaced persons.

Due to the above two constraints, international agencies are more inclined to fund thermal plants than the hydro electric plants. This has resulted in the slow development of hydro electric power plants as Government has had to use its own funds for financing these power projects.

Power position in India is characterised by persistent shortages. Currently the demand outpaces supply. The peak shortage was estimated to be 18.3% in FY 96 while the total demand exceeded supply by 9.2%. The energy demand supply position for the past four years indicates that the shortage varies from a level of 7% to 9% while the peaking shortage ranges from 16% - 20%. The following table illustrates the demand supply position.

Table 3 Demand Supply Position (in MU)

	FY 93	FY 94	FY 95	FY 96
Demand	305266	323252	352260	389721
Supply	279824	299494	327281	354045
Shortage	25442	23758	24979	35676
Shortage (%)	8.3	7.3	7.1	9.2

Government in the Eighth plan envisaged a total addition to capacity of 30,538 MW against which the actual capacity added was only approx. 18,000 MW. This has further aggravated the demand supply imbalance with the peaking shortage reaching well over 20%. Government in the Ninth Plan has projected an additional capacity requirement of approx. 57,000 MW. In order to set up this kind of capacity, the investments required are very high. In this context, the Government's current policy on power sector allows the private sector to set up power plants. As on 31st March, 1996, Government has received proposals for setting up of 124 power projects for a total capacity of 67,281 MW which will involve a total investment of approx. Rs. 2,46,472 crores.

Business Analysis

NHPC currently operates seven projects with a total installed generation capacity of 2133 MW. It account for 8% of the total hydel capacity and 2% of the total installed power generating capacity of the country. A summary of NHPC's seven operational projects is given below:

Table 4 Summary of Operational Projects (FY 97)

Project Location	Capacity (MW)	Date of Commissioning	Remarks
Baira-Siul (HP)	198	1982-83	Taken over from CHPCB
Loktak, Manipur	105	1983-84	Taken over from CHPCB
Salal-I, (J&K)	345	1987-88	Taken over from CHPCB
Tanakpur (UP)	120	1993-94	Originally planned to be commissioned in 1989-90
Chamera I (HP)	540	1994-95	Originally planned to be commissioned in 1989-90
Salal-II (J&K)	345	1996-97	Extension of Salal-I. Originally planned to be commissioned in 1989-90
Uri (J&K)	480	1997-98	Phased commissioning

The performance of the generation stations of NHPC for the past three years shows a consistent high capacity utilisation. The following table will illustrate the same.

Table 5 Projectwise actual and target generation (Gwh)

Project	1996-97 (1)		1995-96			1994-95		
	Target	Actual	Target	Actual	Cap.Ut (%)	Target	Actual	Cap.Ut (%)
Baira-Siul (HP)	750	468.7	750	805	107.3	750	832.9	111.1
Loktak, Manipur	450	331.0	450	486	108.0	450	516.3	114.7
Salal-I, (J&K)	2500	1932.5	2188	2143	97.9 ⁽²⁾	2188	1953.8	89.3 ⁽²⁾
Tanakpur (UP)	460	306.2	460	445	96.7 ⁽³⁾	450	466.9	103.8
Chamera I (HP)	1700	1630.2	1742	2262	129.9	1470	2288	155.6
Total	5860	4668.6	5590	6141	109.8	5308	6057.9	114.1

(1) Actual generation for 1996-97 taken upto November, 1996

(2) Shortfall due to siltation in reservoir and outage of generating units for repairs and maintenance

(3) Shortfall due to accumulation of trash at intake during the monsoon season

Apart from the existing operating projects, NHPC is currently implementing two projects viz. 60 MW Rangit project in Sikkim and 390 MW Dulhasti project in J&K. These two projects are expected to be commissioned during the Ninth Plan (1998-2002). Both these projects have already suffered heavy cost and time overruns. While the project cost for Rangit project estimated was originally estimated to cost Rs. 164 crores and was expected to be commissioned by March 1995, the current revised cost has risen to Rs. 413 crores and is expected to be commissioned by March 1999. The Dulhasti project was planned with bilateral assistance and the work was expected to be completed within 57 months. Due to adverse law and order conditions, the project was stopped in 1992. The original estimated cost was Rs.1263 crores where as the current revised estimate is Rs.3987 crores.

The company has also plans to commission two more projects with a total installed capacity of 990 MW. However, these projects are not expected to be commissioned during the Ninth Plan period.

NHPC has a large workforce of about 13,600 employees. This manpower was inherited by NHPC from CHPCB while taking over the projects undertaken by them. Once the projects were commissioned, over 8500 employees became surplus. Moreover, as and when NHPC takes up new projects, it has to provide employment to one member of every displaced family. This has also resulted in increasing the work force. NHPC had offered VRS in 1992 and about 400 employees opted for the same. Currently, the company is implementing a VRS at an estimated one time cost of Rs.140 crores targeting the currently surplus staff of 5000. This works out to a pay back in 18 months on an annual salary cost of Rs.90 crores.

Tariff Calculation

NHPC calculates its tariff on the basis of the extant tariff policy and parameters decided by the Government of India under the Electricity Supply Act. The company has computed its tariffs till FY 97 as per the norms laid down by the KP Rao Committee Report and Tariff Notification of March, 1992. The policy permitted the following expenses to be recoverable from the tariffs chargeable to the beneficiaries:

- Interest on loan;
- Depreciation;
- Operation and Maintenance (O&M) expenses inclusive of insurance expenses;
- Interest on normative working capital;
- Return on equity;
- Tax on income; and
- Other miscellaneous charges.

The salient features of the policy and the issues involved are highlighted below:

- Interest on loans was recoverable from the tariff on the basis of the approved debt to equity ratio of 1:1, irrespective of the actual financing pattern of the project. In case of projects where the debt to equity was higher, the interest over and above the 12% return provided for equity payable on the excess debt had to be borne by NHPC. This additionally liability cut into the return on equity.
- No provision for recovery of cash to meet the loan repayment liabilities were permitted in the tariff computation. In certain cases where there was delays in execution of projects, repayment started before commencement of commercial operation. The tariff policy took into account repayment as per the approved schedule, irrespective of actual resources generated for repayment. Consequently, loans were taken to meet the repayment obligations. The interest incurred on this loans was also not reimbursable.
- O&M expenses to the extent of 1% of the approved project cost were admissible for hydro electric projects for the purpose of tariff calculations. However, O&M expenses in the case of such projects were higher in view of the nature of the projects, which were not recoverable from the tariff.
- No incentive was offered for generation in excess of the target fixed / designed energy or higher rate for systems stabilisation.

Keeping in view the drawbacks of the tariff policy, Government of India has amended the old Tariff Policy and liberalised it to include the following in the new tariff policy which is applicable from 1997-98 onwards:

- An increase in the return on equity to 16% from 12%
- Interest liability on the basis of the actual financing pattern instead of the notional debt equity ratio of 1:1.
- Provision has been made for advance against depreciation to augment the cash resources to meet the loan obligations
- Enhancement of O&M expenses from 1% to 1.5% of the approved project cost
- Incentive for excess generation and increased capacity utilisation.

Financial Analysis

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

Table 6 Financial Performance (Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	554.2	509.3	480.5	208.7	178.9
Operating Profit	458.6	431.5	408.0	166.4	120.0
Profit after Tax	106.7	77.4	93.7	70.5	41.5
Equity Capital	2917.4	2890.2	2832.7	2832.5	2632.5
Tangible Networth	3568.4	3434.6	3314.6	3230.7	2965.2
Gross Margin (%)	82.7	84.7	84.9	79.8	67.0
Net Margin (%)	19.3	15.2	19.5	33.8	23.2
ROCE (%)	4.0	4.1	5.2	2.2	1.7
RONW(%)	3.0	2.3	2.8	2.2	1.4
Earnings per Share (Rs.)	0.36	0.27	0.33	0.25	0.16

Operating income of the company has grown at a CAGR of 25% from Rs. 178.90 crores in FY 93 to Rs. 554.2 crores in FY 97. This increase is primarily due to improved capacity utilisation and gradual tariff increases. The operating revenue increased more than 100% in FY 95 due to the commissioning of the Chamera-I and Salal-II units which has resulted in an increase in capacity by 885 MW. Generation of hydel power involves low operating expenditure due to non-requirement of raw materials. The main operating costs are manpower costs and cost related to repairs and maintenance of construction equipments. This results in higher operating margins.

The operating margins of NHPC has been consistently above 80% in the last three years.

In spite of the higher operating margins, the net margins of the company is fluctuating at lower levels. This is due to higher depreciation and interest costs. The depreciation charges have shown a substantial increase from Rs.23 crores in FY 93 to Rs.111 crores in FY 97. This is due to the commissioning of the Chamera-I and Salal-II projects. Similarly, the interest costs have increased substantially during the period from a level of Rs.60 crores in FY 93 to Rs. 263 crores in FY 97. The company had to borrow heavily for meeting the project costs. The overall debt of the company rose from Rs.2659 crores in FY 93 to Rs. 5038 crores in FY 97. The company's gross block and capital work-in-progress have increased by 70% over the past five years from Rs. 5248 crores in FY 93 to Rs. 8906 crores in FY 97.

In order to meet the funding requirements for the projects, the company was using various modes of financing. There has been a definite shift from the Government loans to commercial borrowings both in the domestic and international market. Similarly, Government also raised its equity holding in the company from Rs. 2632 crores in FY 93 to Rs. 2917 crores in FY 97. The increasing dependence on debt is also reflected in a decline in the assets being financed out of net worth compared to debt. The gross block/net worth ratio has declined from 56% in FY 93 to 40% in FY 97. The debt service coverage ratio has also shown significant decline from 2.06 times in FY 93 to 1.78 in FY 97.

Strengths and Areas of Concern

Strengths

Large untapped potential There are still vast untapped potential for hydel power generation capacity in India. Only about 25% of the total potential capacity is exploited so far.

Premier organisation NHPC is the premier organisation and nodal agency for the development of hydro electric power in the country. Hydro electric power is a cheap and clean source of energy with low operational cost of generation, steady reduction in the per unit cost of power generation etc.

Talented work force NHPC has a talented work force with substantial experience in the entire range of services associated with the planning, investigation, research, design, preparation of preliminary, feasibility and definite project reports, construction, generation, operation and maintenance of large hydro electric power projects.

Areas of Concern

Intrinsic risky nature of business The setting up of hydel generating capacity is fraught with risks such as :

- High initial investigation costs in terms of time and money
- Long gestation ranging from 6-8 years
- High capital intensity. Investment required for a thermal power plant ranges from Rs.3-4 crores/MW vis-à-vis Rs.4.5-5.0 crores/MW for a hydel power project.
- High costs of development of infrastructure and other facilities in and around the area as most of the power projects are located in remote areas
- High completion risks on account of complexity in design, engineering etc.
- Environmental and social issues
- Dependence of generation on monsoons.

Excess Labour NHPC is saddled with excess labour force. The company has inherited a large labour force from the erstwhile CHPCB. Once the projects were implemented, a large number of the work force became redundant.

Tariff Policy The current tariff policy of Government of India does not cover many issues faced by NHPC as described above, though the policy is under revision.

Recommendation

In spite of considerable hydro electric potential in India, the development has been on a slow track due to a number of problems faced by NHPC in the implementation of large hydro power projects:

- Large hydroelectric projects have higher levels of implementation risks due to high initial investigation costs. In addition, geological surprises during the investigation phase have necessitated revisions in the project costs and this coupled with high costs of development of infrastructure in remote areas has resulted in higher per capita cost per MW for hydro projects when compared with thermal projects.
- Environmental issues such as land acquisition and submersion, rehabilitation of oustees have increased the level of completion risks;

As a PSU, NHPC had to face additional problems. The company's investment plans in new projects have faced considerable delay at the approval stage. The performance of NHPC's main subcontractor - the PSU National Buildings Construction Corporation Ltd, has been far from satisfactory. The company has also been forced by various state Governments to provide employment to the land oustees as a result of which NHPC has nearly 8,000 excess staff on its rolls adversely affecting performance. The free power that NHPC had to supply to State Governments where its projects are located have not helped improve matters either.

Till recently, the development of the power sector was mainly in the public sector. However, due to the inherent nature of the problems of the hydro-electric sector as detailed above, Government has initiated policy initiatives which clearly recognise the fact that the risks of implementing large projects (which have faced time and cost overruns) need to be shared with a joint venture partner as the Government alone may not be in a position to develop the project fully.

In spite of these initiatives, till date no major capacities have been added in the private sector mainly due to two reasons: the relative unattractiveness of large hydro projects when compared with equivalent thermal projects and the rationalisation of a tariff package which recognises the inherent higher risks in hydro projects. As a result, the Government (both at the State and the Centre) continues to supply as much as 98% of the total power supplied in the country.

The process of improving the market contestability in the Indian power sector hinges on a number of crucial issues. Firstly, in view of the poor credit rating of most SEB's the private sector producers are hesitant to supply power on a non-recourse basis. Secondly, tariff reforms will enable SEBs to generate power on a profitable basis. Thirdly, the SEBs in most states are unviable and need structural reforms in terms of unbundling generation, distribution and transmission.

Thus, till the time that the above reforms are in place, NHPC will continue to play an important role in the development of hydro projects. The Commission is of the view that till the time the sectoral reforms in the power sector are complete and the markets are fully contestable, it may be desirable for the public sector to continue to play an important role in the power generating segment. **On these grounds, the Commission reiterates the classification of NHPC as "Core".**

There is scope for enhancement of NHPC share values once the reforms are put in place and the new parameters are settled for tariff fixation. All these are under the active consideration of Government. Due to the unremunerative tariff structure and hence relatively poor rates of return on networth, any disinvestment at present will lead to an undervaluation of the Government holding and result in poor realisation to the exchequer. **The Commission therefore recommends that there should be no disinvestment in NHPC presently.**

However, the Commission would like to point out that reforms alone may not be enough to enhance share value to the maximum extent. The NHPC needs to restructure itself along the following lines:

- **The company should continue to hold its operational projects. The revenue generated from these projects would serve to finance the projects which NHPC has taken up for implementation.**
- **The company should enter into strategic joint ventures with well known reputed international or domestic parties for executing its new projects. This will also help the company to focus on the existing projects and thus improve the managerial attention and control.**
- **Given its track record, the company could aim to provide the entire range of consultancy services related to the development and implementation of the hydro electric power to State Electricity Boards and independent Power Producers.**

- **The company should take up the issue of workforce restructuring by implementing a VRS for the land outstees either through an one time payment to employees or a pension-cum-insurance scheme.**
- **In future, Government would save significantly by adopting a VRS rather than perpetuate employment by providing jobs to oustees till retirement. This is because of the fact that associated overhead costs are cut down which is a medium term saving for the Government. This may be taken into account at the time of formulation of the new hydro policy which, the Commission understands, is on the anvil.**

Government has conferred some autonomy on NHPC in its package announcement for medium sized PSUs. While this is a welcome step, given the nature of its problems, this may not be sufficient. The Commission therefore recommends that NHPC should be conferred autonomy on the lines suggested by the Commission in its First Report for Moderate Performers.

2.6 Pyrites Phosphates & Chemicals Limited

Evolution

Pyrites Phosphates & Chemicals Limited (PPCL) was set up in 1960 with the objective of exploration and exploitation of import substitute pyrites and rock phosphate ore deposits for the production of fertilisers. The company is currently engaged in mining of pyrites, production of single super phosphate (SSP) and mining and sale of rock phosphate. The company has manufacturing facilities at three locations Amjhore (in Bihar), Saladipura (in Rajasthan) and Dehradun in Uttar Pradesh.

The paid up share capital of the company is Rs. 84.73 crores and the entire equity is held by Government of India.

Industry Analysis

Fertiliser is an important input in improving the productivity of soil. The fertilisers can be classified on the basis of nutrient contents. Nitrogen (N), Phosphorous (P) and Potassium (K) are the primary nutrients which are required in large quantities. Urea is the main nitrogenous fertiliser while Di-ammonium Phosphate (DAP) supplies both nitrogen and phosphorous. Single Super Phosphate (SSP) supplies phosphorous inputs to the soil and Muriate of Potash (MoP) supplies potassic inputs. As against DAP and urea which supplies primary nutrients, SSP with a phosphorous (P) content of 16% and sulphur (S) content of 12%, supplies a primary and secondary nutrient respectively. It is thus classified as a low analysis fertiliser as per the Fertiliser Control Order, 1985.

The total primary nutrient consumption was about 14 million tonnes in FY 96 out of which P-nutrient consumption accounted for 21%. Within this segment, SSP fertilisers accounts for about 17% (by consumption) DAP for about 55% with the balance consumption being accounted by complex fertilisers.

Rock phosphate and Sulphuric acid are the raw materials used in the manufacture of SSP. In India, rock phosphate deposits are found in Rajasthan and Madhya Pradesh. Most of these deposits are of low grade and requires beneficiation to make the mineral acceptable as feed stock for fertiliser manufacture. These rock phosphates are suitable for manufacture of SSP and bulk of the requirements of rock phosphate used for DAP fertiliser production is imported. Similarly, sulphur deposits in India are negligible and consequently significant amount of sulphur are imported for use in the fertiliser industry.

The SSP industry is highly fragmented with about 85 units with an installed capacity of 6 million tonnes. Out of this, one-third in number is in the small scale sector. PPCL accounts for about 6% of the total SSP industry capacity with the industry leader Dharamsi Morarjee Chemicals Company Limited (DMCC) accounting for nearly 10% of the industry capacity.

Government of India de-controlled the P & K fertilisers segment in August, 1992. All restrictions on the prices of these fertilisers and on the region of sale for the manufacturers were lifted. Government subsidy was also abolished. The impact of the de-control was as follows:

- Substantial increase in farmgate prices of de-controlled fertilisers and consequent decline in their consumption. The consumption of SSP fell from a level of 3.2 million tonnes in FY 92 to 2 million tonnes in FY 93.
- The fall in the consumption of P&K fertilisers led to a rise in demand for urea. This distorted the consumption pattern of N,K&P fertilisers.

Subsequently Government announced certain concessions to bring down the cost of production of P & K fertilisers to arrest their decline in consumption. Ad-hoc subsidy was re-introduced on DAP and MoP in October, 1992 and on SSP in June 1993. To begin with, the ad-hoc subsidy on SSP was Rs.340 per tonne which has been increased over the years and is currently at Rs.600 per tonne. Subsidy on DAP and MoP are Rs. 3,750 per tonne and Rs.2,000 per tonne respectively. The retail price of SSP products are generally fixed by State Governments.

The future outlook on SSP are as follows:

- SSP is regarded as a poor man's fertiliser as its cost per bag is lower than DAP. Demand for SSP is expected to grow in the future as production of oil seeds (for which it is mainly used) is increasing.

- As raw material costs accounts for more than 80% of the price, to be viable SSP units will have to manufacture at 80-90% capacity utilisation.
- As a result of the re-introduction of the subsidy, the consumption has shown improvement and in FY 97, the consumption has risen to pre-control levels. This is expected to be maintained in the future too.

Business Analysis

The main business activities of PPCL are as follows:

Table 1 Plant Locations of PPCL

Plant Location	Started operations	Capacity ('000 tpa)
Amjhore - SSP Production	October, 1988	264
Amjhore - Acid Production	December, 1989	99
Saladipura - SSP Production	January, 1997	99
Saladipura - Granulation	December, 1997(*)	60
Dehradun Mining of Rock Phosphate	1965	60

(*) Expected month of Commissioning

Originally the Amjhore unit was set up in 1969 for mining of pyrites solely for supply to the Sulphuric acid plant of Fertiliser Corporation of India (FCI) at Sindri. Consequent to the closure of the pyrite based sulphuric acid plant by FCI at Sindri in November 1982 due to uneconomical operations, the activities at Amjhore came to a standstill and the entire workforce became idle. In order to deploy the idle workforce, PPCL proposed to set up a phosphatic fertiliser plant. The company received the approval for setting up a SSP unit alongwith the sulphuric acid plant in October, 1986. The SSP unit started operations in October, 1988 with bought out acid. The sulphuric acid plant came on stream only in December, 1989.

The company went for exploration of pyrites in Rajasthan in 1979 and submitted a proposal for setting up of a SSP plant and a pyrite based sulphuric acid plant in 1980. However, the project was found unviable and was abandoned. In order to engage the workforce, the company decided to set up a 300 tpd SSP plant based on bought out acid. The company has tied up for the acid supply from Hindustan Copper Limited which is situated over 100 kms away. Apart from the SSP unit, the 200 tpd granulation plant is expected to be on stream by December, 1997.

In Dehradun, PPCL is engaged in the business of mining rock phosphate deposits. The rock phosphate is ground and sold as a direct application phosphatic fertiliser in acidic soil, mostly in the Southern States and Assam. This product is sold under the brand name “Mussorie Phos” (M-Phos).

The production and sales of products of PPCL for the past five years are as follows:

Table 2 Production and Sales of PPCL ('000 Tonnes)

	FY 97	FY 96	FY 95	FY 94	FY 93
Amjhore Unit - SSP					
Production	211	183	171	129	177
Sales	187	161	179	161	129
Dehradun Unit - M-Phos					
Production	125	120	121	118	98
Sales	105	107	100	107	103

The performance of SSP production was affected by the de-control of P-fertiliser sector but has subsequently shown improvement. Production and sale of SSP from FY 92 to FY 96 remained the region of 150000 tonnes . However, the production and sales improved during FY 97 and has crossed the 200000 tonnes level. During FY 96, PPCL had to shut down its plant for two months (October and November) due to inadequate availability of rock phosphate. This has affected its sales in FY 96.

The cost of production of SSP at Amjhore plant is high when compared with competitors due to pyrite route of acid production. Because of this, the operating cost is significantly high.

The employee cost of PPCL is high due to the large workforce engaged in the mining operations. The total manpower strength of PPCL as at March, 1997 was 2426 and almost 1300 employees are engaged in the mining and related activities.

PPCL predominantly caters to the eastern States of Bihar and West Bengal. Madhya Pradesh is the main consumer of SSP. Any producer catering to this market will have a competitive edge over other producers. Even in the markets where PPCL is having significant presence, a number of private companies have started operations. They also offer longer credit periods and higher discounts to dealers and customers.

Apart from the mining and manufacturing activities, PPCL is engaged in the trading of fertilisers. It started its trading activity in fertiliser in FY 90 with handling and distribution of urea. PPCL commenced trading in DAP, MoP and other P&K fertilisers after they were de-controlled in 1992. PPCL was one of the co-canalising agencies for urea imports during 1994-96. Trading has accounted for a significant portion of the turnover of the company in all these years. However, the margins in trading operations have been low and insignificant to compensate for the sizeable losses incurred in the manufacturing activities.

Financial Analysis

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

Table 3 Financial Performance (Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Net sales	105	81	78	76	67
Trading Income	274	543	172	180	248
Operating Income	379	624	250	256	315
Operating Profit	10.3	2.8	4.5	2.8	16.3
Profit after Tax	-8.3	-0.7	-5.9	-15.5	-8.3
Equity Capital	84.7	82.7	77.7	74.7	70.7
Tangible Networth	40.0	45.4	40.1	42.1	52.6
Gross Margin (%)	2.6	0.4	1.7	1.0	5.2
ROCE (%)	2.9	10.0	7.4	2.7	11.8

Note: Other ratios have not been presented as they are all negative

As can be seen from the above table, trading has contributed significantly (between 69% to 87% of total income) during the last five years to the turnover of the company. PPCL has been incurring losses in both manufacturing and trading activities. Due to the consistent incurring of losses, the equity of the company has eroded to Rs. 40 crores despite fresh infusion of equity from time to time. The accumulated losses were Rs.35 crores as on 31st March, 1997.

Amjhore unit was showing operating profits due to incentives which the company receives. PPCL is receiving an ad-hoc subsidy of Rs.600 per tonne on SSP and it also receives import substitution incentive payment of Rs. 580 per tonne of SSP production. The total incentive impact for FY 97 for both Amjhore unit and Dehradun Unit works out to be approx. 28 crores.

The Government also granted major reliefs to PPCL without which its financials would have been much worse. The major reliefs granted are as follows:

- Rs.6.92 crores (50% of the plan loan of Rs.13.83 crores as on December, 1994) was converted into non-cumulative redeemable preference shares for a period of 5 years to be redeemed in 3 annual instalments from 2000-01.
- Moratorium has been granted till 31st March, 1996, on the remaining portion of the loan. No repayment schedule has been finalised as yet.

The company has also adjusted accumulated expenditure at Amjhore of Rs.31.95 crores prior to commissioning as follows:

- Rs.11.34 crores, out of the non-plan loan of Rs.13.9 crores drawn between 1984-89 was converted to grant-in-aid in 92-93. Interest thereon of Rs.5.2 crores was adjusted
- Remaining Rs.2.55 crores has been treated as interest free loan with a moratorium till March, 1996.
- Waiver of accumulated interest and penal interest of Rs.2.44 crores granted.
- Additional amount of Rs. 1.58 crores waived during 1990-92.
- Balance of Rs.13.85 crores being amortised over 18 years.

Strengths and Areas of Concern

Strengths

Production of Cheap Fertiliser The principal product of PPCL is SSP which is considered as a poor farmer's fertiliser as the cost of SSP is much lower when compared with other fertilisers. Given the price sensitivity of the average Indian farmer, the production of a cheaper alternative of fertiliser is a strength for the company.

Areas of Concern

High Raw material Cost PPCL produces sulphuric acid from pyrites instead of procuring the acid directly or making it from sulphur. As a consequence, this process is almost twice as costly when compared with competitors.

Locational Disadvantage PPCL's market is primarily in the eastern region. However, the maximum demand for SSP comes from Madhya Pradesh. This has put PPCL in a disadvantageous position.

Large labour force PPCL employs 2426 employees. On the average, the employee cost as a percentage of total operating income for PPCL is almost three times when compared with its competitors. This is primarily due to the mining operations which employs about 1300 employees.

Dependence on Incentives PPCL depends on Government to the extent of Rs. 600 per tonne as ad-hoc subsidy. Additionally, PPCL also receives import substitution incentive of Rs.580 per tonne. Delays in receipt of these incentives would impair liquidity and any removal of these incentives will make operations unviable.

Poor expertise in trading activity and infrastructure for trading PPCL does not have a dedicated trading department with the required levels of infrastructure for monitoring demand and marketing. The company also lacks financial flexibility to tide over temporary demand supply imbalance.

Government Options on PPCL

As brought out in the analysis above, PPCL is currently at a critical stage due to unviable manufacturing operations, high level of competition and dependence on Government for sustaining operations. As the principal shareholder, the options available to Government at this stage are highlighted in the Table below:

Table 4 Government Options on PPCL

	Scenario	Government outflow	Remarks
1	No action taken by Government due to paucity of funds	Government subsidy of about Rs. 20 cr. p.a.	Losses will continue to mount; likely to be referred to BIFR; Action on disinvestment will be delayed
2	Close down Dehradun operations and sell the Amjhore and Saladipura units on as-is-where-is basis	VRS for Dehradun operations will cost about Rs. 35 crores	Government will save subsidies of Rs. 20 crores as well as conversion costs in the other plant to the extent of Rs. 20 crores; However as buyers are unlikely to be interested the company may be referred to BIFR
3	Close down Dehradun operations. Switch over Sulphur based production at Amjhore; close down mining operations and sell the units after conversion	VRS for Dehradun and Amjhore units will cost about Rs. 79 crore; switch over will cost about Rs. 25 crore	Government support in terms of subsidies during the switchover period of two years would be necessary. The switchover may help increase investor interest as well as realisations.

The options are further elaborated below:

Scenario 1 The company has been incurring cash losses in the past. The networth of the company has already been eroded from Rs. 53 crores as at 31st March, 1993 to Rs. 40 crores as at 31st March, 1997 despite equity infusion of Rs.14 crores. Despite receiving direct as well as indirect subsidies, the company has posted increasing level of losses. At present, the subsidy scheme has been extended by the Ministry of Fertilisers for one more year but the continuance of the incentive scheme in future is uncertain. In this event, Government would have to continue subsidising increasing level of cash losses year after year.

Scenario 2 Under this option, the Government could close down the unviable operations in Dehradun after paying fair and equitable compensation to the affected employees which is estimated to cost around Rs. 35 crores. The units at Amjhore and Saladipura could be sold off to fertiliser companies who do not have a presence in the phosphatic fertiliser segment. However, while the buyers would have to implement the switchover to sulphur based production of SSP, the Government may have to continue the subsidy till the changeover is complete. However, the large mining workforce may prove to be a deterrent for buyers and may dampen investor interest.

While Government may save by way of stoppage of subsidies, the exit from the business may not prove to be smooth.

Scenario 3 Under this option Government assumes responsibilities for both restructuring the mining workforce as well as implementing the switchover plan. The cost of closure of mining operations both at Amjhore and Dehradun would be the cost of VRS for about 1500 employees amounting to approximately Rs. 79 crores. However, it is assumed that the implementation of the change over to sulphur based SSP production would be done by the company without any time or cost overruns. By this action, Government will pave the way for an easy exit from the business.

Recommendation

The Commission classifies PPCL as non-core due to the following reasons:

- PPCL's original objective of making use of locally available pyrites for the manufacture of SSP and thereby conserve foreign exchange for the country is no longer relevant as all import restrictions on phosphates and sulphur have been completely removed.
- Due to low entry barriers, the SSP fertiliser industry is highly fragmented with as many as 85 companies competing with each other. PPCL's market share is currently just 6%. The markets are thus contestable and no public purpose is served by sustaining a loss making public sector.

The analysis has clearly highlighted the unviability of the Dehradun operations. The Commission recommends that Government should in the first instance evaluate the possibility of finding buyers for the Dehradun mines. This will sustain employment at the unit to some extent besides reducing the funds required for implementing the VRS. If buyers are not available, the Commission recommends that Government sell-off the assets in the Dehradun operations after giving fair and adequate voluntary retirement benefits to the employees engaged in these operations.

The analysis of the options indicate that the Government - in case of the other units at Amjhore and Saladipura - would have to decide on whether to restructure the operations before disinvestment or sell on an as-is-where-is basis. The Commission recommends the following course of action:

Government should initiate action to sell the Amjhore and Saladipura units to a strategic buyer who would eventually implement the switchover to sulphur based production of SSP as outlined in Scenario 2. For this purpose, these units will have to be demerged from the Dehradun operations and clubbed together for the purpose of the sale. Government subsidy will have to be continued for two years even if the unit is in the private sector.

PPCL should also initiate action to implement a VRS policy on the lines suggested by the Commission in its Fourth Report. This will help the company to rationalise the workforce during the changeover period. The funds required for this purpose could be made available from the Disinvestment Fund as proposed by the Commission in its First Report.

Government should also appoint Financial Advisers who could assist in the demerger and subsequent valuation of the units. The Financial Adviser could also help in fixing a reserve price for the sale apart from managing the bidding process. The procedure for appointing Financial Advisors for the sale has been outlined in Part B of the First Report of the Commission.

If the bids received by Government are below the reserve price, the Commission recommends that the Government should provide budgetary support to PPCL to enable implementation of the changeover to sulphur based SSP production. At the same time, the Government will also have to continue to provide subsidy as long as the SSP is produced through the pyrite route and continue running the pyrites mines till the change over is complete. After implementation of the changeover, Government could initiate steps to disinvest its entire holding to a strategic buyer.

2.7 REHABILITATION INDUSTRIES CORPORATION LIMITED

Evolution

The Rehabilitation Industries Corporation Limited (RICL) was set up in 1959 at by the Government of India in Calcutta with the primary objective of rehabilitating refugees from Bangladesh, Burma and Sri Lanka. Employment opportunities were sought to be created through the establishment of manufacturing facilities required in low to average skills industries such as industrial estates, taxi co-operative societies, sponsorship of powerlooms co-operative societies and extending loans to private entrepreneurs and co-operative societies. Defence / Government offtake was expected to absorb a major part of RICL's production.

Over the next few decades, RICL commissioned production centres in West Bengal, Madhya Pradesh, Orissa for the manufacturing of light engineering items, ironing casting, textile, food processing, wooden and steel furniture, leather footwear, garments etc. The company also diversified into project engineering in the late seventies.

The share capital of Rs. 47.62 crore is held entirely by Government. Presently, the company is under the administrative control of the Department of Heavy Industries under the Ministry of Industries.

Industry and Business Analysis

RICL's turnover since inception has been lower than break-even levels resulting in persistent losses and the consequent closure of 21 units by 1991. All the employees of the closed units were absorbed in the 13 operating units resulting in substantial overstaffing.

Since 1992, the production activities have been suspended in all units except the Projects division and Industrial estates further contributing to the overstaffing problem. The snap shot of the various divisions of RICL and unitwise share of turnover and loss figures for the financial year 1995-96 are shown in the table below :

Table 1 Unit wise Turnover of RICL for 1995-96

Division	Units	% turn over	% losses
Engineering	Projects	89%	-1.6%
	Fabrication	0.4%	1.9%
	Cast Iron Foundry	0.3%	0.7%
Textiles	Handlooms	Nil	2.7%
	Powerlooms	Nil	1.2%
Consumer Products	Processed Foods	Nil	1.1%
	Garments	Nil	0.9%
	Leather Footwear	Nil	0.6%
Services	Industrial Estates	9%	-0.1%
	Tours & Travels	Nil	Nil
Head Office		1%	93%
Total		100%	100%

Note: Negative figure of loss actually represents the profits made in that division

As seen from the above table, the Projects Division and the Services Division have contributed 98% of the operating income and absorbed about 2% of the losses of the other divisions. As the turnover from the other divisions is nil, the industry analysis is limited to the Engineering segments.

Engineering

The Engineering industry is characterised by low skill and capital requirements which has led to a proliferation units particularly in the small scale sector. The low technology of the product manufactured implies average product quality and differentiation on the basis of quality is a key success factor. The typical problems confronting the sector are the lack of marketing concept, working capital, appropriate technology and trained manpower.

The demand for products made in the engineering segment are concentrated in geographical regions where industrial projects are set up. Specifically core sector project like steel and mining and infrastructure projects like bridges and ports drive demand for the engineering / project divisions.

Engineering products are facing a threat from new products made of plastics and composites which are light and cost effective. These are replacing some of the traditional engineering products such as castings.

Finally, the impact of new pollution control standard is likely to affect the production structure of the industry as well as the product mix that is rolled out. Considerable emphasis is likely to be placed on R&D since the pollution control equipments will have to be cost effective and suited to the medium / small scale foundries.

RICL's Competitive Position

All the engineering products made by RICL are marked by high competition, typically from the small scale sector. The absence of significant differentiation or value addition has resulted in RICL's inability to command a premium in the market. The quality of the products from the cast iron foundry and fabrication units generally meets requirements, but RICL is not able to meet time schedules. As a consequence of the above, the competitive position of the company is weak.

The projects division does not undertake jobs which require high / specialised skills and concentrates on coal handling plants, industrial sheds etc. Vulnerability to competition is high in all areas where RICL operates.

The projects division finance itself through mobilisation of advances and payment received from clients. Delays in receiving payments put an additional strain in meeting completion schedules as RICL's own financial position is precarious. The bidding system employed by customers usually factors in the financial strength of the contractor and RICL is at a disadvantage in this respect.

In addition, the absence of a manufacturing back-up in the project division has adversely affected the company's competitive position. RICL faces competition from large players like L&T, McNally Bharat and TRF Limited. RICL has a severe disadvantage in not having a back-up facility or any long term arrangement with any manufacturer. Though the absence of in-house facility does lower overhead costs, this is offset to a large extent by the lack of effective procurement management systems which is critical to the profitability of this division.

Financial Analysis

Table 2 Past Financial Performance (Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	51.6	116.9	103.8	108.7	46.7
Operating profit	-72.6	-54.8	-46.7	-43.5	-32.4
Loss	-71.2	-53.77	-46.3	-39.8	-32.0
Equity Capital	47.6	47.6	47.6	47.6	47.6
Tangible Networth	-394.9	-323.4	-269.6	-223.3	-183.4

Note: Ratios have not been presented as they are all negative.

As indicated earlier, over 96% of the operating income emanates from the Projects division as all other divisions have been closed since 1992. The variability in earnings of RICL over the past five years can be completely attributed to the uncertainties associated with this line of business. However, the contracts taken on by this division do not fully cover costs as a result of which the margins are negative.

As seen from the Table 2 above, losses have increased at a steady pace mainly due to increased interest costs. Employee costs have shown a falling trend from between FY 92 to FY 96 due to the introduction of VRS but subsequently increased due to the hike in wage rates in 1996-97. Presently, the company's workforce is sustained on the basis of an annual budgetary support to the extent of about Rs. 10 crores.

As a result of the losses, the networth of the company has been fully eroded and the accumulated losses stood at Rs. 399.44 crores as on March 31, 1997. Due to the erosion of networth, RICL was referred to BIFR in May 1992, but BIFR turned down its registration on the grounds of the company being a conglomeration of number of small scale units. In February 1995, it re-applied for registration with BIFR, but was denied registration due to non-possession of Registration Certificate under Industrial (Development & Regulation) Act.

Areas of Concern

Low capacity utilisation The maximum capacity utilisation attained has been in the region of 50%. All units which were operational till 1991-92 began closing down and currently no manufacturing facility is operational.

High break even levels High fixed costs, mainly employee related, have resulted in high break even levels for the units. This coupled with low utilisation levels has resulted in all the units registering losses even at the operating level. It would appear therefore that barring Projects and Industrial Estates, most units are unviable on account of the adverse cost structure.

Under utilised labour force Since RICL was set up with the objective of generating employment the surplus labour exists not only in terms of number but also in terms of higher wages being received in relation to their productivity. This has significantly raised the cost of the company's products and services and made them uncompetitive in the markets.

The extent of surplus labour is illustrated in the table below :

Table 3 Surplus Labour in RICL (FY 97)

Division	% of surplus labour
Head Office	10%
Industry Estate	6%
Consumer Products	8%
Engineering	18%
TOTAL	42%

Sub optimal resource management The most critical feature of RICL's manufacturing units is inefficiency in manpower, material and funds management. The management of labour is very poor on account of dominant labour union. This has rendered ineffective any attempt to upgrade productivity levels and rationalise manpower.

Government Options on RICL

As is evident from the above analysis, RICL has ceased to be operational in most of its business activities and the annual government support is almost fully utilised for the payment of employee costs. The company has an accumulated loss of about Rs. 400 crores, besides a consistent track record of default on loans availed from either Government or banks.

Almost all the commercial units run by the company are in highly contestable areas and will fall in the non-core category. The company was started with the social objective of providing measures of rehabilitation to refugees mainly from Bangladesh. However, the analysis of its business has clearly brought out that none of the ventures of the company has proved to be commercially viable and, in the face of sustained losses over the last several years, the company has been almost exclusively dependant on Government budgetary support for payment of wages. The analysis also shows that none of the units of the company would be of any commercial interest to prospective buyers. A decision on disinvestment of Government equity in the company would, therefore, rest on finding a satisfactory solution to the problem of the employees for whose benefit the company was started. Since all the commercial activities of the company have negative contributions, the budgetary support from Government goes to fund not only the direct cost of labour but overheads involved in providing employment to such labour. Any solution which would limit Government's assistance to the support of labour will be preferable to running the company incurring losses which are much more than the cost of providing livelihood to refugee beneficiaries. The various options available to Government are analysed in the subsequent paragraphs from this angle.

Table 4 Government Options on RICL

	Scenario	Government Outflow	Remarks
1	No action taken by Government	Rs. 10 crores p.a. till all the employees retire by the year 2034	The present value of the support (discounted at 13%) is about Rs. 70 crores. In addition, the bank dues of Rs. 30 crores will need to be settled. Terminal value of assets will be negligible.
2	Implement Revival Plan through additional Budgetary Support	A one time grant of Rs. 28 crores for VRS + Rs. 7 crores for working capital.	Revival of the company is unlikely. The plant and machinery has remained idle for more than five years.
3	Structure an attractive VRS for all the employees and close down operations	Rs. 35 crores for the VR compensation Rs. 30 crores for payment of bank loans.	Inspite of an outgo, the Government will save when compared with option 1

Option 1

RICL's accumulated losses of Rs. 400 crores as on March 31, 1997 against a paid-up capital of Rs. 47 crores has resulted in a negative networth of the company. The BIFR has already turned down a reference and further, if no action is taken by Government, losses will continue to multiply. Effectively, Government will be funding the employees wage bill till their eventual retirement. The present value of future payments to the employees is estimated to be Rs. 70 crores. This is on the assumption that there is no increase in the salaries of the employees till their retirement. If this is factored in, the figure could be much higher.

Most of the plant and machinery have already been shut down for five years. If they continue to be unutilised over the next five to six years, the terminal value will be close to zero or may be even negative.

It may also be mentioned that RICL owes banks to the extent of Rs. 30 crores. It is likely that these banks may initiate proceedings in a Debt Recovery Tribunal for the recoveries by filing a winding up petition.

Option 2

RICL has drawn up a turnaround plan which is based on the following:

- Modernisation of all units
- Continue with same set of employees and use contract labour if needed
- Additional Government support to the extent of about Rs. 20 crores (one-time) apart from the annual support of about Rs. 10 crores.

It is envisaged that the restructuring plan will take three years to implement and the benefits will thus be available only from FY 2001. With this implementation, the company is expected to recover from its loss making situation and post profits.

The Revival Plan is unlikely to succeed due to the following reasons:

- The company is engaged in businesses which are highly competitive and in which the unorganised private sector has a strong competitive advantage. RICL lacks any competitive advantage in this regard.
- Given the lack of managerial skills and the relatively low levels of morale in the organisation, the effective implementation of the plan is considered very difficult.
- The plant and machinery have remained idle for more than five years and their condition will not allow realisation of turnover to the extent projected.
- The turnaround plan has not been appraised by any financial institution or bank.
- RICL's accumulated losses of Rs. 400 crores against an annual turnover of Rs. 80-100 crores make the possibility of revival in the near future highly unlikely.

Option 3

If the company were to close down all operations and provide an attractive VR scheme the total outgo on such a scheme would be around Rs. 35 crores (1286 employees @ Rs. 2.5 lacks per employee). In addition, the retiring of bank loans will account for about Rs. 30 crores.

Taken together, this will be still lower than the costs incurred for perpetuation of the company.

Given the company's present financial position, the Government is unlikely to recover its past dues or the principal amounts itself. Thus, there may be no option but to waive off entire principal with the accumulated dues.

Recommendation

The analysis of the options before Government indicates that the most prudent course of action would be to discontinue all operations and waive all outstanding Government loans together with interest. In fact, all divisions, excepting the Projects and the Industrial Estates division have already shut down for more than five years. **A detailed examination of these divisions by the Commission reveals that they are not capable of recovering all costs.**

Besides, the variability of income from these divisions is high due to the uncertainties associated with this business.

The analysis of options also reveal that Government could save significantly by structuring an appropriate labour scheme (either a one-time payment to employees or a pension-cum-insurance scheme) rather than perpetuate employment in the company till all employees retire. This will cut down overhead costs associated with the business resulting in a saving for the Government.

The commission therefore recommends that RICL should, with immediate effect, discontinue all operations. However, existing contracts taken on by the company to the extent unavoidable should be completed and no new contracts should be entered into by the company.

Prior to discontinuation of operation, the Commission recommends that Government should announce a package for the employees. The scheme should inter-alia cover the following:

- A pension-cum-insurance scheme in lieu of a one-time payment for the employees based on the last salary drawn. An outline of the scheme has already been given by the Commission in its Fourth Report and is reproduced in Annexure 1.
- Career counselling on available alternative options. If the level of skills developed by an employee is high, Government should actively assist the employee in finding alternative jobs.

- **In its Fifth Report, the Commission had pointed that for those employees who may not opt for the pension scheme but would like to set up a commercial venture with the lumpsum VRS payment, the management of the PSUs in collaboration with organisations like the Industrial and Technical Consultancy Organisation in the State should organise a counselling service so that they may be properly guided as regards alternative investment options like establishing a small business venture or retraining to seek alternate employment. RICL is a conglomeration of businesses and if some of the employees are interested in running these units jointly, Government should encourage handing over after suitable pre-qualifications. In such cases, the lumpsum amounts payable on account of VRS could be adjusted against the value of the assets.**

At a later point in time and if necessary, Government may also appoint Financial Advisers who could assist in the sale of the assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.

Annexure 1

Voluntary Retirement Scheme (VRS)

The Voluntary Retirement Scheme (VRS) has been described in detail in the Commission's Fourth Report. This is reproduced below.

The studies carried out by the Commission of the PSUs covered in its Reports reveal that several PSUs including the profit-making ones have staffing levels well in excess of the comparable competing units in the domestic and international markets. Given the need to remain competitive in a globalised business environment it is important and necessary that all PSUs continually review their staffing levels and take appropriate measures to balance the size of their workforce. This process will be facilitated if a stable VRS policy providing meaningful financial and other benefits is put in place.

In its Second Report the Commission has recommended that Government announce a stable VRS policy with reference to its terms and conditions and provide adequate funds for its implementation by different PSUs. In actual fact the Commission has come across instances where PSUs who have implemented the VRS Scheme have not been able to secure funding support from Government.

The Commission would like to elaborate further on this subject as the future of several PSUs and the value of shares sold will change for the better if surplus employees are provided acceptable VRS terms. The following steps are recommended :

- 1. The terms of VRS should be finalised as early as possible on a stable and long-term basis. Individual management may be given a range within which they may deviate from the prescribed terms for different age groups, different categories of employees and different industrial sectors.**
- 2. Prompt funding should be assured to all PSUs which implement the VRS scheme. The Disinvestment Fund can be used for this purpose as recommended by the Commission in its First Report.**
3. The terms and benefits of the VRS scheme should be clearly brought to the attention of the employees through suitable publicity measures.
- 4. As there is danger of a one-time lumpsum payment being frittered away by the employees or drained out by unscrupulous middle men, a special scheme may be drawn up through**

commercial banks, UTI or LIC, wherein the VRS benefits are invested on behalf of individual employees to provide long-term benefits and some measure of social security. To illustrate, the scheme will be able to provide with an investment of about Rs. 2 to 3 lakhs for 10 to 15 years a monthly income of around Rs.2000 together with annual lump-sum payments for meeting expenses on account of family functions etc. to individual employees. Insurance cover may also be provided to the individuals. This could in fact be structured to become an Employees Pension - cum - Insurance Scheme. Banks and other institutions should be persuaded to open special branches, if necessary, at the locations of the undertakings to service the scheme.

In the absence of an effective VRS particularly in loss-making or marginally profit making undertakings, an unfortunate and inevitable consequence will be an increasing sickness of the PSU with a progressively increasing burden on the budget and eventual closure leading to unemployment of the entire workforce in the process. **An effective VRS scheme can ensure long term productive employment for a substantial number of residual employees in a going concern. It will also fetch better prices for shares sold by Government.**