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Academy of Corporate Governance

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Following is the presentation made by Dr.Y.R.K.Reddy at the First Lecture of SCOPE Economic Forum, on 10th December, 2014, New Delhi.

Public Enterprises Reform for Economic Spurt – Case for a Fresh Approach

1st Lecture of the Scope Economic Forum

New Delhi, 10th December, '14

By

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Outline of the Talk

1. A quick recall of the setting: of the inflexion points for SOEs and their reform worldwide, and of a snapshot of SOEs in India and the economy.
2. Key current international moves & critique in the Indian context: The notable recommendations / experiences as part of Corporate Governance advocacy – aggregation of ownership rights / SPV; disinvestment / public listing etc.,
3. The coming tide & the opportunity for reform plan, de novo:
   - Two key imperatives.
   - Why the current approach could cause entropy and a debate on what should be the directional path for SOE reform for measurable impact on the economy.

1.A Quick Recall

- Inflexion points for SOEs and their reform worldwide –
  - Euphoria – Reconstruction efforts and the 50's and 60's; the socialist Europe rapid growth model; late industrialisation and under developed markets in the third world etc.
  - Doubt – The 70's and the 80's after Thacherism,
  - Rejection – The massive privatisation movement – "patrimonial capitalism" to liberal capitalism thru strategic competitive ownership, particularly in Latin America; the first round of liberalisation & privitisation in India; the first round of reform in China etc. ''The giveupitis" ?
  - Disaffection but unwillingness to let go: symbolic reform, partial disinvestment - but some cases of serious re-nationalisation and rescue. (New Zealand, UK, South Africa etc. – earlier episodes of Latin America too)
  - Rebound of the doubt after 2008 rescues in the UK and the USA....recognition of SOEs as an inevitable component of economy; validation of our early arguments; the focus on improving the governance standards of SOE's adopting a capital-market centric approach and supporting, the agency model assumptions.

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Source: KPMG – Public Sector Enterprises, 2012

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Performance Snap-shot

(source: Ministry of HI & PE, 24th Feb 2014):

As on 31.3.2013, there were 277 CPSEs (229 in operation and 48 under construction.

(i) Investment in CPSEs:

- Total paid up capital in 277 CPSEs stood at Rs.1,85,282 crore (growth of 13.07% over previous).
- Total investment (equity plus long term loans): Rs. 8,50,599 crore(16.63% growth over previous year)
- Capital Employed (Paid up capital plus reserve & surplus and long term loans) Rs.15,32,007 crore (a growth of 13.23 % over previous year).

(ii) Turnover, Profit/ Loss and Net Worth:

- Total turnover/gross revenue: Rs.19,45,777 crore (6.79 % growth over previous year).
- Profit (profit making co.,): Rs. 1,43,559crore (growth of 14.00 %)
- Loss (loss incurring co.,) Rs. 28,260 crore in (increase in loss by 2.08 %).
- Net profit: Rs.1,15,300 crore (up by 17.36%).
- Reserves & Surplus: Rs. 6, 81,409 cores (increase of 9.26 %).
- Net worth: Rs. 8,66,691 crore in 2012-13 (a growth of 10.05 %).

III)Contribution of CPSEs to the Central Exchequer:

- Contribution of CPSEs to Central Exchequer by way of excise duty, customs duty, corporate tax, interest on Central Government loans, dividend and other duties and taxes :Rs.1,62,761 crore (an increase of 0.22%).

(iv) Foreign Exchange Earnings by CPSEs:

- Foreign exchange earnings: Rs.1,38,150 crore in 2012-13, (a growth of 8.03%).
- Foreign exchange outgo: Rs.6,46,262 crore in 2012-13 (increase 11.9%).

(v) Market Capitalization and Stock Exchanges:

- Total Market Capitalisation: The total market capitalization of 46 CPSEs stood at Rs.11,16,817.00 crore (a decrease of 11.21% over previous years 45 co. – i.e. 17.64% of BSE Marcap.

2. Key International Moves & India

- The CG framework from OECD and World Bank in late ‘90s against background of AFC.
- Precursor arguments from India (in‘98, 2000).
- The OECD‘s SOE Guidelines in 2004: As SOEs constitute 30% of GDP in China; 38% in Vietnam; about 25% in Thailand and India; 15% in Malaysia and Singapore; Marcap of 25% in India, 50% in Malaysia and 60% in China (+ employment + fiscal revenues + ripple effect).

Notable Show-casing

Aggregation of shareholding rights –

- SASAC, SCIC, Druk Holdings following some European examples like Stratum.
- The mixed experience in China so far while large numbers still operate in the old fashion; the fresh strategic reform plan for 6 companies – and eagerness to look at M & A..
- Is Khazanah of Malaysia (2004) an exception?

Implications for a holding company model in India.

- How possible is cabinet re-engineering for creating the ecosystem – separating regulatory vs. ownership?
- The potential for capture under some political conditions?
- Composition and competence – “adverse selection” possibilities?
- Unchanging oversight burden – does it imply an additional layer. Old wine in a new bottle?
- Is a more structured / nuanced approach possible? (geographical or sectoral?)

Public listing & Disinvestment:

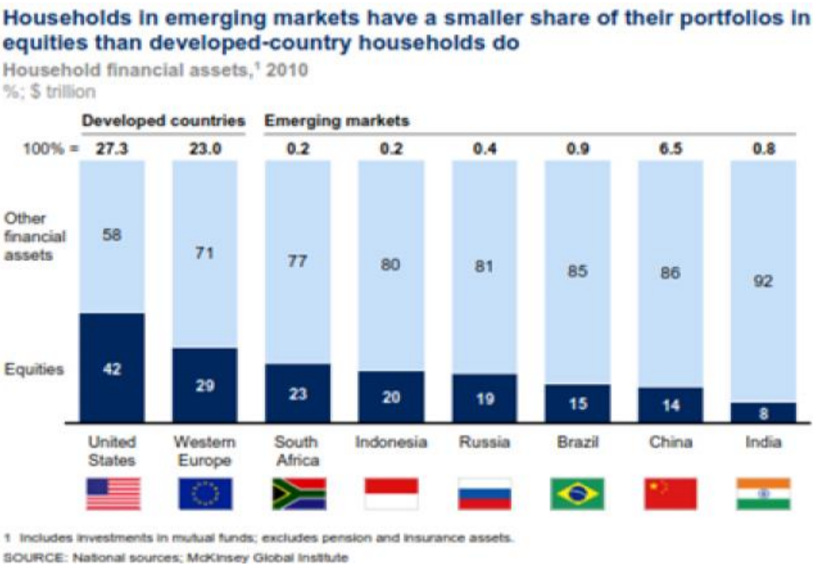
- Is the idea only to fix fiscal stress or for efficiency thru exposure to market conditions?
- Have they imbibed a culture to address markets or address the Govt., only?
- Do penalties for non-compliance work?
- Is there regulatory, legal and enforcement forbearance that causes “moral hazard”?
- When there is no bankruptcy possibility or a “market for control” what would be the impact on potential investors? Would it be dominated by lateral transfer of ownership from one SOE to another? (Will it induce “crowding-out” of private entrepreneurship?)

3. The coming tide for SOEs & the opportunity for de novo approach.

Two key trends and how they will define SOEs future and contribution to the economy.

- The emerging terrible global equity gap amidst fractional participation. (Where will SOEs be when many companies chase meagre risk-capital?)
- Vulnerability of SOEs in the wake of disruptive technologies, finance cruch, competitiveness (does the governance overburden allow quick and massive make-overs, M & A etc? Will they be allowed to get to the idea of value extraction / creation – not just compliance oriented corporate governance?).

Source: McKinsey Emerging Equity Gap - 2011



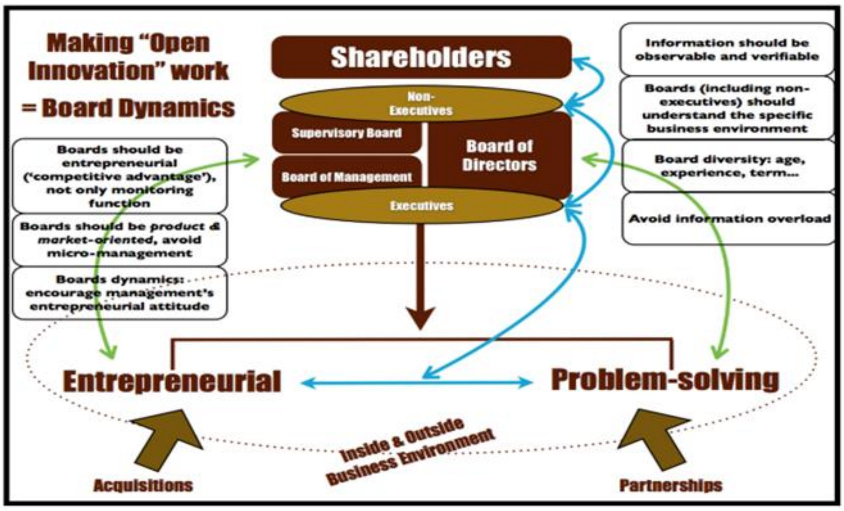
Source: McKinsey Emerging Equity Gap - 2011

The 12 Disruptive Technologies:

Refer: Mc Kinsey

Value Creation, Growth and the Economy:

- The Idea of Value Creation – underscores the survival aspects of companies, especially the SOEs, which have the weight of the past; governance oversight and other issues. (value extraction from hidden pools of slack to precede?).
- Corporate governance compliance necessary but not sufficient.
- Value creation is not just short-term shareholder returns – it is the ability to be relevant continuously without asset diminution, to survive and contribute to the economy and society. (it is yet to be reduced to a metric but the idea is compelling).
- Boards can play a key role.



Source: Erik P.M Vermeulen, Entrepreneurship and Innovation in Listed Companies: What is the Role of Corporate Governance? - 2012

- How to ride the tide for economic impact ?:
- Three possible broad paths for debate:
  - Mapping the oversight mechanisms, regulatory overburden and the transaction costs – leading to hard choices to expose SOEs to market challenges – (can we learn from other countries that do without a CVC, CAG, Article 12, a Govt Company etc?).
  - Making hard choices on reengineering the cabinet and then the govt-SOE interface – SPV or a Coordinating mechanism (Stakeholder Executive of UK) or a hybrid? With or without a an intermediary step of “Red-lines“ of interface between Govt and SOEs.
  - Increasing interface with market institutions (shareholders, providers of finance, research analystss, credit rating agencies etc., than the Government) for invited discipline – aquiring the ability to ride the tides!!

Riding the Wave??

“The value of public commercial assets (the government property that generates profits such as CPSEs, SLPEs, Railways, Utilities etc.) is as much as the Hedge funds, Pension funds, Sovereign funds all put together.

“If central government managed their assets better, they could generate annual returns of roughly $3 trillion, or more than the world’s yearly investment in infrastructure including transportation, power, water, and telecommunications. Every percentage point of improvement on annual global portfolio returns would generate the equivalent of GDP of Saudi Arabia.”

Dag Detter & Stephen Folster, Foreign Affairs, Nov. 24th 2014.

- For debate: In the case of India, with a 10% better value extraction p.a (at least in the first three years of low hanging fruit) can one expect a spurt of anywhere around 1.8% p.a impact on GDP? (Nominal GDP 12-13 est., at Rs. 1,04,72,807 Crores) ?
- + mitigating redundancy risks and increasing longer survival prospects – averting the death-wish syndrome?
- + providing demonstration effect for SLPE reform and reform of various other public commercial assets that will, in turn, generate a ripple effect?

Snapshot

Dr.Y.R.K.Reddy addressing the SCOPE Economic Forum with Director-General Dr.Choubey, Presiding

Inaugural Session of the 12th Programme on Corporate Governance at SCOPE, 11-12th December, 2014. Right to left: Mr.Peter Greenwood, International resource ACG; Mr.C.S.Verma, Chairman, SAIL; Mr.K.D Tripathi, Secretary, DPE; Dr.U.D.Choubey, DG-SCOPE; Dr.Y.R.K.Reddy, Lead Resource, ACG

Review - 2014.

Activities during 2014 have been considerably lower than the earlier years considering the general slow-down in capacity building activities in corporate governance and a possible introspective phase among multi-lateral bodies on the assumed model and framework. The following are the key contributions:

1. Op-ed article at the request of Vidwat, the management journal on *Corporate Governance – Will It Deliver Value than Fluff?* Vidwat, Jan.

2. Assistance to CII-Southern Region in designing the Governance event and giving the Keynote address on *Governance – Pointers for Debating Critical Challenges*, 7th, March.

3. Assistance to IFC- Washington relating to critique of the proposed regulation on *Corporate Governance Practices for Public Listed Companies in Kenya*, 20, June.

4. Assistance to SADC-DFRC, in updating material, programme design and contingency management of the *Corporate Governance Programme for SADC DFI* in Lesotho, July.

5. Addressing the Wada Na Thodo Abhyan, the leading network of civil society organisations, on *100 Days of NDA Government*, New Delhi, 1st September.

6. Address to ICP-WX - International Certificate Program in Business Management for the Women Executives of CPSE of India on *Corporate Governance Framework and Developments*, 22nd September.

7. *Dialogue on SOE Governance*, Abu Dhabi, 27th September.

8. A Note for SCOPE on *Global Trends in Governance of SOE*, October.

9. A Note for the Government on *Swaatch Bharat Mission – Addressing the Design Challenges*, October.

10. First Lecture of SCOPE Economic Forum, on *Public Enterprise Reform for Economic Spurt – Case for a Fresh Approach*, 10th December.

11. SCOPE's *XII Programme on Corporate Governance for CEOs and Directors*, with Founder President and Mr. Peter Greenwood as lead and international resource persons, at SCOPE Convention Centre, New Delhi, 11-12, December, 2014.