

# THE ECONOMIC TIMES



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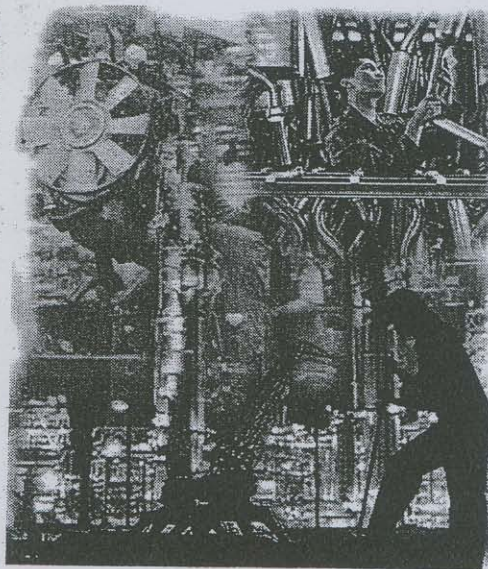
## A formula to end perils of PSU profligacy

It is imperative that PSUs adhere to established corporate governance principles. Resultant increase in PSU profits could be an effective tool which the government can use to build infrastructure & reduce tax pressure on citizens, says Sumant Batra

**T**HE Indian private sector got another reason to smile as the recent acquisition of Corus by Tata Steel has brought the Indian corporate house at the centre of the global attention. With its track record of global acquisitions in recent years and the marvellous growth in the domestic market, the Indian private sector has proved its potential beyond doubt. While the country continues to bask in the glory of the private sector growth, the policymakers are under more and more pressure to provide the supporting environment to maintain its forward march. Strengthening the corporate governance of Indian companies, in particular those listed, is one such issue which has received the priority attention of the government. While Sebi continues to improve corporate governance regime for listed companies, ministry of company affairs is considering upgrading corporate governance framework in the new company law.

In this growth story of the private sector, the role and importance of PSUs and the attention they need in governance reform, somehow, appears to have got lost. PSUs represent a substantial part of GDP, employment and market capitalisation. There are over 1,300 PSUs in India which contribute one-fourth of GDP, have nearly 28% share in industrial production, account for more than one-third of the total revenue receipts of the central government exchequer and provide 1.7 million direct and indirect employments. There are about 1,036 state-level PSUs spread over 28 states. PSUs are prevalent in key utilities and infrastructure industries, such as railways, posts, ports, transport, defence and telecommunication. Performance of these firms are of great importance to broad segments of population and to other parts of the business sector. The governance of PSUs is, thus, critical to ensure their positive contribution to a country's overall economic efficiency and competitiveness.

PSUs were set up post-independence, as crusader of socio-economic objectives, for spearheading planned development in India, promoting rapid industrial development, balancing regional development, generating employment and creating basic infrastructure networks. They served their purpose in some areas while failing in the other areas. While some PSUs became successful corporations, the others turned sick. Growth of India's private sector, liberalisation of markets, deregulation of previously monopolistic markets and increase in competition, in the last decade, have thrown in a number of challenges for PSUs. Modelled on functioning in a closed and protected economy, mainly dependent on the state for financial resources, most PSUs failed to adapt to the new dynamics of doing business. This has created a need for readjustment and restructuring of PSUs, including an urgent in-depth review of their governance.



**A major challenge is to find a balance between the state's role as the owner and the need to avoid political interference in the management of the company**

The shared experience of countries that have started to reform corporate governance of state-owned enterprises is that this is an important and complex undertaking. A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions and the need to avoid undue political interference on the management of the company. Another important challenge is to ensure that there is a level-playing field in markets where private sector firms can compete with state-owned enterprises and that govern-

ments do not distort competition in the way they use their regulatory or supervisory powers. The challenges in India are no different.

Although corporate governance framework of PSUs is no different from that of the private sector, PSUs also face some distinct governance challenges. They may suffer just as much from undue hands-on and politically-motivated ownership interference as from totally passive or distant ownership by the state. As an OECD study suggests that corporate governance difficulties of state-owned enterprises derive from the fact that accountability for their performance involves a complex chain of agents (management, board, ownership entities, ministries and the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities to ensure efficient decisions and good corporate governance is a challenge. The government often tends to protect them from two major threats that are essential for policing management in private sector corporations, i.e., insolvency and bankruptcy.

OECD has recently prepared guidelines for corporate governance of state-owned firms. The guidelines provide general advice that will assist governments in improving the performance of state-owned enterprises in the following areas: ensuring an effective legal and regulatory framework for such firms, the state acting as an owner, equitable treatment of shareholders, relations with stakeholders, transparency and disclosure and the responsibilities of boards of state-owned enterprises. The Centre should use these guidelines. The decision to apply the guidelines to the governance of PSUs should, however, be made on a pragmatic basis. They have sufficient flexibility to allow the countries to adopt them as per local dynamics. PSUs can be a major contributant to the Indian economy. In recent times there has been nine times increase in dividends and 245% increase in contributions to the state exchequer. This can multiply manifold if the PSUs were to be governed in a manner that allows them independence in decision making. Global experience shows that good corporate governance of state-owned enterprises is an important prerequisite for economically effective privatisation, since it will make the enterprises more attractive to prospective buyers and enhance their valuation. PSUs can be a major contributant to the Indian economy and beneficiary to the government. In recent times there has been significant increase in the dividends and contributions made by PSUs to state exchequer. This can multiply manifold if the PSUs were to be governed on established corporate governance principles. This money can contribute immensely into building of infrastructure of the country and easing tax pressure on citizens.

(Author is senior partner, Kesar Dass B & Associates)