Session 4
Corporate Governance of State Owned Enterprises

Remarks by Session Chairman:
Mr. Jagdish Khattar, Managing Director, Maruti Udyog Limited

Members of the Panel, Ladies and Gentlemen. As a person who has worked in the public sector units for almost a decade and as a citizen of this country, I believe the public sector has played a stellar role in India's development. We have been able to nurture and build a sizeable number of public sector companies that are better than most in the private sector.

More than 15 years after economic reforms were ushered in, the public sector continues to be a dominant player in Indian business. While employment in the public sector has declined in the last two decades, nearly 60% of the Government's plan outlay is still funded by the PSUs.

I am therefore a little disappointed that both the Government and its enterprises are diffident when it comes to the Corporate Governance. They believe, they are distinct from private enterprise and hence eligible for certain concessions in following the norms of governance. I accept that public sector units are indeed distinct from the private units but that is more reason, not less to embrace the best in Corporate Governance. Nothing will be a more powerful signal to the private sector, then if the Government itself chooses to adopt the higher standards of Corporate Governance for its own enterprises. Investors, employees and customers, infact civil society in general have now started to expect their institutions to deliver higher standards of governance, whether it is private sector units or government organizations or research and education or the voluntary sector, the civil society demands that they come good on transparency, disclosures and fairness.

I wish, India's public sector units would see this as an opportunity to make their systems and processes more robust and bring them in line with global practice rather than as a set of rules fired at them from which they need to duck. Yes, State owned enterprises are distinct from private entities. They are owned by people whose tenure of ownership is limited. They are prone to political interferences in decision making. Their accountability systems for their managements are excessive and ineffective. We all know of it. Public sector chiefs suffer in silence or occasionally raise a storm of it.

Enlightened politicians and reform-minded Ministers wring their hands in anguish at this state of affairs. Now, when opportunity knocks in the form of mandatory independent directors, should we all not grasp at it with both hands. Should not PSU Chiefs and enlightened Ministers push aggressively for independent directors on PSU boards, genuine, qualified, independent directors, not Government nominees, masquandering as independents.

Independent directors will bring fresh perspective and experience. There will be a balancing influence between the politicians and the boards of the enterprises. Rather than take this opportunity, we have state-owned enterprises pleading for concessions on this account. Of course, state-owned enterprises must be careful to compensate these directors adequately. This is one area where the public sector may be overdoing its difference with its private counterparts. In the process, we are being unfair to the outstanding talent in the public sector and loosing the opportunity to attract more talented people to it.

I am pained as are so many well wishers by the sheer scale of auditing and monitoring that PSUs managements are subject to. Layer upon layers of auditors are constantly passing judgment on business decisions at local, regional and central levels of the organization. Never mind, if in the process, they miss the big picture of the business. For decades, the bane of state-owned enterprises has been PSU managements operating at sub-optimal level, fearful of the implications of multi-layered auditing.

Now independent audit committees, offer us a way out. Independent audit committees, as laid down in the Corporate Governance norms, are our best chance to unshackle PSUs from such futile monitoring and scrutiny and replace it with something more effective and more sensitive to the nuance of business decision making. Here again, our PSU managements should go the whole way and put in place effective audit committees rather than plead for compromise and concession. State-owned enterprises are distinct also because they have a larger social function complementing the profit motive. It could be anything from ensuing India's energy sector to promoting regional balance and access to remote areas. That social objective is supposed to be the rationale for their existence, the reason why the State has invested in that business in the fist place.

Frankly, I see no contradiction in this except that this must be disclosed to the public in a transparent fashion, which brings me to the rights of minority shareholders. Government sometime tends to be brazen in ignoring the rights of minority shareholder and their enterprises but I am optimistic that this will change. The major factor that will foster better Corporate Governance is the State's weak financial position. Governments have little choice but to subject their enterprises to the rigor and discipline of the market. We are already seeing that in a way, Government-owned companies are having to approach the capital market to raise funds through public issues. As listed entities, they are bound to follow the norms of Corporate Governance laid down by the Regulator. When they approach the market, their need for transparency and disclosures is even more urgent and critical.

For companies that are not looking to raise funds from the market, there is the discipline of the customer. They know, they have to deliver better value for money than their competitor. There are no bail outs or goodies to the State to hand out. The UPA Government, which has a pragmatic approach to the public sector, recognizes and I pointed that chronically loss-making companies will have to be sold off or closed. Governance of corporate will have to fall in line to deliver on product, on cost, on quality and on satisfaction.

I am sure, more and more Public enterprises will appreciate this dimension of Corporate Governance, more as a weapon for boosting competitiveness than as a static bunch of regulations to be complied with.

Thank you.

Presentation
Mr. Louis Bouchez, Senior Corporate Governance Specialist, OECD Secretariat

Presentation:
Mr. Oliver Fremond, Program Co-ordinator & Ms. Varsha Marathe, Financial Specialist, World Bank of America

Presentation:
Mr. K. D. Tripathi, Joint Secretary
Ministry of Heavy Industries and Public Enterprises, Government of India

Mr. Khattar, Mr. Bouchez and Mr. Chairman, you have already seen the other three panelists and the presentations made by the World Bank where they have given the setup under which the public enterprise in India are functioning.

I would only like to highlight certain points. As already mentioned, there are about 240 State owned enterprises, leaving aside the financial sector and the departmentally run undertakings. In respect of these enterprises, the Government has been maintaining the 'Arm's length' policy, that means, the ownership functions and there has been an attempt to distinguish between ownership functions and the management functions and the day to day management has been left to the Board of Directors and the administrative Ministries and the department of Public Enterprises. They only issue the guidelines, they just administer the guidelines which are issued for management of these enterprises within the broad policy framework of the Government.

The major initiatives taken by the Government have been with respect to professionalisation of the Boards, which started as early as in early seventies when the Economic Administration Reforms Commission was set up and based upon their recommendations, the professionalisation of Boards policy was laid down. Second major reform came in the year 1991 when the Industrial Policy resolution was laid in Parliament and further professionalisation of the Boards was announced in pursuance of that policy.

Over and above, slowly after that, the financial delegation of the companies has also been enlarged, enhanced and as you know, many companies were designated as 'Navratna', 'mini navratna' where they had been given enhanced economic and financial freedom to act upon.

Then there has been, as already mentioned in the presentation, the selection of directors is through Public Enterprises Selection Board and very recently, the Government has laid down the guidelines about qualifications for appointment of the independent directors, where the educational qualification, age and professional experience has been prescribed.

There are certain issues which emanate from the Parliamentary accountability of the administrative ministries. As you know, our Article 12 of the Constitution prescribes that even public enterprises are treated as arms of the State, so far as the Courts and other legal judicial remedies are concerned. Infact, the Public enterprises, their managements and Chief Executives, have expressed their concern that this sometimes inhibits their functioning as one of the questions that the Parliament are asked, to which, essentially they are asked on the commercial judgments of the companies and their commercial secrets so the companies have been demanding that they should be exempted from such scrutiny and such revelations.

Government is conscious of these concerns of the Public enterprises as well as other agencies. Recently a committee was set up under the Chairmanship of renowned Economist, Dr. Arjun Sen Gupta, which has given its recommendations. Part of the recommendations regarding financial and economic delegations etc. have already been implemented but the larger issues which Mr. Khattar also pointed out about audit, vigilance, parliamentary accountability, these are under the process of consultation and the Government will try to come out, after the consultation process is over and that the consensus of various regulatory bodies and the agencies like Controller and Auditor General of India, Chief Vigilance Commissioner and we are in the process of consulting the Lok Sabha and Rajya Sabha Secretariats and based upon the outcome, the Government will definitely take certain action.

As already mentioned, there are about 40 enterprises, which are listed in the Stock Exchanges, which are not in financial sector. If you take financial sector enterprises also, there would be about 60 or more and their market capitalization is substantive portion of our Indian economy, infact, the largest market capitalization among all Indian companies is one of the public enterprises. So, there are success stories on both the sides, public enterprise as well as other enterprise, there are stories of failure on both the sides. It cannot be concluded that simply because an enterprise is a state-owned enterprise, it would not function in a better fashion or it will be functioning in an improved manner and similarly it cannot be interpreted that if an enterprise is not State owned, it will definitely function better. Infact, there were many state-owned enterprises, which were taken over by the Government after they fell sick. Out of 244 enterprises, about 80 of them are sick and a large number of them have been taken over by the Government to protect the interest of labourers and others and after they become sick or non-functioning.

So, what I am trying to say is that the Government is conscious of the developments taking in the field of Corporate Governance and the effort is always to improve the Corporate Governance and to give more and more freedom to the enterprises to function in a competitive manner and to exercise the financial and management delegation powers and of course the State has to exercise its ownership functions, to that extent, there will always remain a difference between the state-owned and the other enterprises.

Thank you.

Question and Answers

Question:
Sir, certain issues were raised by the speakers regarding the milking of state-owned enterprises. In any enterprise, the policy of divisible profits and dividends is a management issue and therefore, I do not see any reason why question should be raised when the Boards of state-owned enterprises decide to distribute their dividend. They are conscious of what are their development plans are and I am sure that they are not oblivious of what is the need for funds for development, they do it at the cost of, if there are any States to the effect that the public sector enterprise, available resources have been totally diverted for Government purposes, there should be an in-depth study to that effect and there should not be a kind of minus point in evaluating the freedom of state-enterprises to distribute their dividend. This is more so, when public sector enterprise have now public equity participating and there are persons who are other than Government, they are equally benefited, if there is a dividend distribution. Question is that when the public sector enterprise are labeled as being milked. The answer was given that, as long as there is transparency, their objective is known and why it is being spent, it is okay. As far as that is concerned, I can tell you, from my experiences, I am in some companies, we are in Board of Directors, I am not talking about Maruti, some other joint ventures. The decision is taken in America and we are told that this is the decision of the owner because they are the majority shareholders. We accept it. So its really the dictates of the majority shareholder that decides the dividend policy

The person who pays, the piper dances according to that. I am on the Board of a company, majority shareholding is with an American company and their decision is 90% of the profit is to be given as dividend.

On the issue of dividend, there is of course the dividend payout, which is important, meaning how much of the earnings generated by the company can be distributed, which is a critical issue.

The second issue, where do the dividends go when it is an SOE. Now, in most countries, it goes straight to the treasury and the centralized unit does not have authority over the dividend paid by the SOEs, that they may oversee. There are exceptions. In Singapore, a complete latitude to reinvest the dividend paid by certain SOEs in other SOEs and in Sweden, which is a rather interesting case in point, the Parliament has given a limited mandate over time and over size to the Ministry of Industry to re-invest the dividend paid by SOEs into other SOEs, so it is a limited mandate in time and in size, which kind of calls upon the role that Parliament can play in SOE governance, when it plays an active role.

Response:
As regards to the observation about milking the State-owned enterprises or paying dividends etc., I must mention one fact that many of the enterprises, which are today very profit making and declared 'navratnas' or 'mini ratnas', most

of them were set up long back, 25 / 30 years. I will just give one example. Take the example of BHEL. Its paid up capital is 250 crores, 244 crores to be exact and its net worth is 5500 crores and if it gives a dividend of 400 or 500 crores, in terms of capital, it may turn out 200% dividend but if you compare it with its reserves, its net worth and its turnover, it is hardly anything. Is there any private sector company having net worth of 5000 crores and giving hat little dividend, it cannot survive in the market and people will not invest in that company and second point which was made by our other panelist that if a dividend is paid, it goes to a consolidated fund of India, which is used for development purposes or Government spending and when the authorized capital or paid up capital has been given, it is the public money, it is the public fund so the public is definitely entitled to a return, a shareholder, a Government does not mean that there is an individual, it is the public of India, so if they have invested the money, they are definitely entitled for a return on that.

You are right, Mr. Tripathi but an example I can give you. Maruti has a reserve of 5000 crores, our dividend is only 45 crores and not 400 crores, so any way, it all depends, at the end of the day, you have to see what the company's programmes are. There is no point giving away dividend and company does not have enough resources for further expansion so some amount of balance has to be done and there are always various demands so some balancing act has to be done in that.

Question:
My question is addressed to Mr. Tripathi. He has talked about the freedom given to the Boards of the PSUs, way back from 1970's but the feud between ONGC and the Ministry of Petroleum is open secret. Any comments on this issue.
Response:
I would not like to make any specific comment on that issue because the issue really, if there is at all any issue, that Ministry of Petroleum and the ONGC is under the administrative jurisdiction of Ministry of Petroleum but the comment which I would like to make is that the functioning of the Companies has to be as per the Company law and as per the decision of the Board of directors. In the Board of Directors, there are three kinds of directors, functional directors, Government nominee directors and the independent directors. Whatever decisions are taken in the Board meeting, these are the decision of the Board. Their members may have difference of opinion in the Boards but ultimately whatever is the collective decision of the Board, that matters. After an individual member of the Board, if he airs his views publicly, that is a different issue, it is his insider of the story but what has been discussed in the board rooms, perhaps media does not know but the fact remains that ONGC is a prime performing company of the Government and Government would like to see its functioning improved and to that extent, if government also likes to give certain policy directions, I think the Board of Directors will take it in that light and then ultimately they will take decision. I am not aware of any such thing where government has

given any specific directions to any particular issue on a commercial decision of the board. There is no such case, at least to my knowledge.

Question:
With regard to the plethora of organizations or the people who are having control on a Public sector enterprise, the latest entrant is the 'Right to Information Act'. Now, this is something which is totally corroding, what you call the privacy of the public-sector enterprise. Any person, calling himself a citizen, he wants to have any information with regard to last eight years, ten years, twenty years and he just has to ask the question and you have to give it. Why should the public sector enterprise be exposed to these risks when there are listed companies also. They are being asked to give information as to what amount they have spent on entertainment, what amount they have spent on website.

Could we kindly confirm ourselves to the governance issues because right to information is different
Response:
We have heard from Louis in his presentation, the guideline did recommend that there is information that be made available not only to Parliament, which is the ultimate entity, to which SOEs are accountable to but also to the general public and quiet often the information that is being prepared for Parliament is about the same information that is being made available to the general public in perhaps a more diluted way or less comprehensive but what the public would like to know is information at the aggregate level. That means, take up the entire SOE portfolio and look at how things are evolving over time. That is some type of information that the public would like to hear about and lot of shareholders, who are interested, would like to have information, I repeat, at the aggregate level and then for large SOEs that have a very large public good function then it is also important to be able to provide information at the level of SOE itself.

There are various countries that do it and some of them do it better than others. For once, I am happy to say that my own country in France is one of the best in providing information at the aggregate level. I am not saying that it does very good at managing its SOE portfolio, I think, there is lots of problem in French SOE governance but as far as aggregate reporting, as far as disclosure to the public is concerned, it is a good case that can be analyzed and perhaps emulated.

I think, this is something different, that disclosure, as a part of the stakeholders is different and part of the governance. He is talking about right to information, which is a new Act which has come into the country, where they can ask for, even confidential information, that is the thing which has started, so I think, it is a little different than the disclosures that you are talking about.

Question:

Is the Government considering the issue of separation of the Chairman and the CEO in state-owned enterprises. My second question which might appear naïve to people who live in Delhi is, from where does the Government, identify directors to sit on PSU Boards.

Response:

At the present, as I explained, the structure of a Board of a Public enterprise consists of three kinds of directors, functional directors, nominee directors and the independent directors. Independent directors are selected through the same agency which selects the functional directors, that is Public Enterprises Selection Board, which is a body of professionals under the Department of Personnel and Training. They select the independent directors and finally the appointment is made by the appointment committee of Cabinet, again, which appoints the functional directors as well as independent directors.

As of now, the policy is that there should be Chairman-cum-Managing Director in the company, which is appointed by the Government

Just one final thing. I think, the Ministry could have a look at the guidelines. We do suggest to indeed split the function of the CEO and the Chairman.

Comments by Mr. Jagdish Khattar:

What appears is that basically there is an acceptance that we will continue to have Public sector enterprises because they have a role to play but at the same time, with the changing times, changes have to take place and there has got to be a balance between the objectives for which these enterprises were set up and also the fact that more stakeholders are coming, they have to be efficient and also work in the market economy, so therefore, there are different models, we have seen, there are two/three models, India has a different model but we are moving away and finding our own model but the bottom line is that there is a possibility of their remaining efficient and achieve their objectives. If along with that, the essence and principles of Corporate Governance are incorporated, as we go along.