

CHANGING ROLE OF PUBLIC SECTOR ENTERPRISES  
IN INDIA

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**Introduction**

Public Sector Enterprises (PSEs) or State owned and managed units have played a strategic role in the Indian economy. The key factors contributing to stronghold of these enterprises are the need of rapid industrialization with equitable distribution of economic wealth and inadequacies of free market. India witnessed a greater degree of state ownership and increased regulation since second plan that envisaged industrialization as a development strategy. By 1980s the poor performance of state-owned companies was acknowledged and various efforts were made to improve performance. In an era of economic reform process initiated since1991, privatization has become a key component of public sector policy of the government. The survival of PSEs now depends upon performance efficiency and profitability.

**Definition of Public Sector Enterprises**

Public Sector Enterprises often referred to as government owned undertakings/enterprises or state-owned enterprises are wholly or partly owned and controlled by the government and produce marketable goods and services i.e. PSEs include industrial and commercial enterprises which are managed and controlled by government. Public sector and PSEs are different from each other. The word public sector is wider and includes all kinds of organization commercial (i.e. PSEs) and non-commercial that are owned partly or fully and effectively managed by Government. Thus, Government funded universities, colleges, hospitals, schools are part of public sector but are not PSEs because these organizations lack commercial orientation.

**Rationale of Pses In India**

The policy rationale for public ownership and government provision of certain goods and services has been based on the presence of some form of market failure, which are addressed through public ownership. In India, PSEs are assigned the responsibility of fulfilling specific social goals like correcting regional and economic imbalances, providing employment and reducing the concentration of monopoly power in the economy. Further, as a pre-requisite for balanced growth, the state controls the key sectors of the economy which is popularly known as the 'commanding heights' rationale of PSEs. The rationale of PSEs in India as discussed as follows:

**1. Rapid Economic Development**

The prerequisite of faster economic development is the creation of infrastructure and the growth of basic industries like power, steel transportation; communication, banking etc. These industries require huge capital investment and involve long-gestation period and so private sector may not be interested to undertake the development of such industries. Further, the private sector lack financial and technical skills to develop such industries. In other words, reluctance on the part of private entrepreneurs to develop key industries due to high risk and low returns necessitated the establishment of PSEs. Government with its capacity to mobilize huge economic resources can develop the industries that are significant for growth prospects of the country.  Thus, in the earlier phase of development heavy state spending on investment in basic infrastructural sectors and service facilities (for example financial institutions, telecommunication banking etc.) is essential for providing a congenial atmosphere to the private sector to facilitate the process of accelerated development of the economy.

**2. Reduction of Concentration of Economic Powers**

PSEs reduce inequalities of income through welfare programs, favorable pricing policy towards small industries and supply of cheaper goods to the consumer. Private sector may manipulate the price of essential goods and indulge into quick profit-making by controlling the volume and price of such goods.  PSEs prevent such concentration of economic power.

**3. Balanced Regional Growth**

Private sector generally neglects backward regions that lack infrastructure and other basic facilities such as power, roads, telecommunication, skilled labor etc. PSEs set up large projects in these areas and spend huge cost to develop such areas. In this manner, PSEs help to achieve balanced regional growth.

**4. Employment Generation**

The adequate generation of employment opportunities is a major objective of the public-sector enterprises. This sector has provided direct employment to more than 80 percent of organized labor.

**5. Import-Substitution and Export-Promotion**

In the initial period of development foreign exchange constraints exist due to huge imports of capital goods and low exportable surplus. PSEs produce importable goods domestically which tend to save precious foreign exchange and facilitate exports.

**6. Resource Mobilization**

PSEs mobilize savings through large network of banking and financial institutions. The profits of PSEs are ploughed back into developmental activities of the country. Further, PSEs contribute to the Government’s exchequer through payment of tax and dividends.

**CLASSIFICATION OF PUBLIC SECTOR UNDERTAKINGS**

Public Sector Undertakings (PSUs) can be classified as State Public Sector Enterprises (SPSEs), Central Public Sector Enterprises (CPSEs) and Public Sector Banks (PSBs).

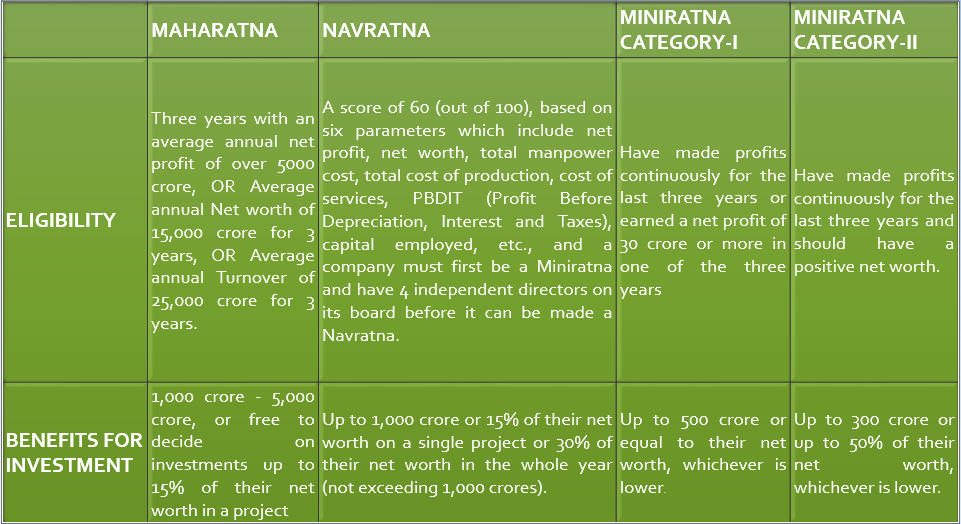
The Central Public Sector Enterprises (CPSEs) are also classified into 'strategic' and 'non-strategic'. Areas of strategic CPSEs are:

* Arms & Ammunition and the allied items of defense equipment, defense air-crafts and warships
* Atomic Energy (except in the areas related to the operation of nuclear power and applications of radiation and radio-isotopes to agriculture, medicine and non-strategic industries)
* Railways transport.

All other CPSEs are considered as non-strategic.

**MAHARATNA/ NAVRATNA/ MINIRATNA STATUS FOR PUBLIC SECTOR UNDERTAKINGS**

The status of Maharatna, Navratna, Miniratna to CPSEs is conferred by the Department of Public Enterprises to various Public Sector Undertakings. These prestigious titles provide them greater autonomy to compete in the global market.



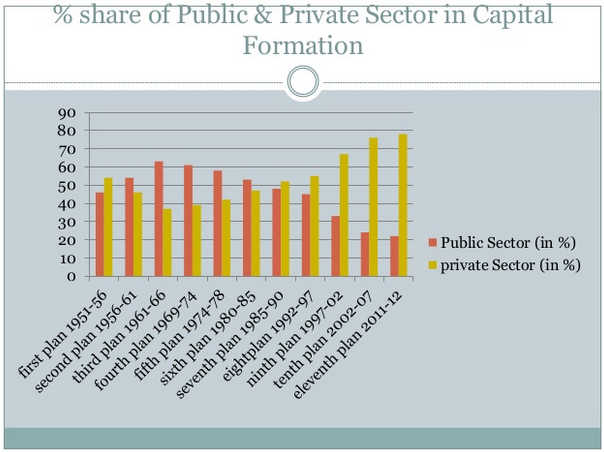
**ROLE AND CONTRIBUTION OF PSE IN INDIA: RECENT EVIDENCES**

The role of PSEs in the provision of social and economic infrastructure has been impressive. It has significant contribution to the country’s economy by filling the gaps in the industrial sector, generating employment and balanced regional development.  The major contributions of PSEs are explained as under:

Contribution towards Industrial Development and GDP Growth

The role of Indian PSEs in the process of industrialization is widely acclaimed. The PSEs has helped to build sound and diversified industrial base. The capacity creation by PSEs in basic industries such as generation and distribution of electricity, telecommunication public transportation stood at around 50 percent. In case of basic metals fuel and fertilizers it stood at 80 percent to 100 percent. These industries are central to economic development process of industrialization. PSEs contribute around 27 percent of total industrial production of the economy. On the eve of the First Five Year Plan there were 5 central public sector enterprises (CPSEs) with a total (financial) investment of Rs. 29 crore. Both the number of enterprises and the investment in CPSEs recorded an overwhelming increase over the years, especially so after the Second Five Year Plan. As on 31st March, 2007, there were a total of 247 CPSEs with a total of Rs. 421089 crores. The contribution of PSEs in the real gross capital formation as depicted in table2 clearly indicate that PSEs occupy a significant position in the process of country’s capital formation and holds commanding heights of the economy.

As far as the share in national production is concerned, central PSEs in the 1950-51, contribute 3 percent of national income which has increased to around 8.23percent in 2006-07.



**Problems FacED BY Pses In India**

**1. Defective Pricing Policy**

The prices of goods and services produced by the PSE in India for long have been determined by Govt. under administered price regimes (APR). In post-91 era with intense market competition Government has dismantled the APR in most cases and PSEs have been given independence to fix their own price competitively. In the recent years, various price regulatory commission for regulating prices in best interest of both consumers and producers have been established whose recommendations are applicable both for private and PSEs. Government on its part continues to be sensitive to the needs of the poor and price level in the economy. Any rise in price generally warranted by market conditions is avoided. Pricing of petroleum is an example in this respect. The rise in the international price of crude oil is hardly passed on to the consumers. The social approach set prices in PSE causes a lower returns and financial losses.

**2. Excessive Political Interference**

There exists considerable political interference in the operational aspects of PSEs in terms of appointment in the management, pricing of products, location of projects. The decisions are guided by political considerations and not by economic factors.

**3. Delays in Decision-Making**

The red-tapism and bureaucratic management causes delay in decision-making of these organizations. PSEs thus fail to take advantage of opportunities thrown open by the market.

**4. Over-Manning**

The public-sector enterprises are overstaffed. It increases cost of production and inefficiency in the organization.

**5. Lack of Accountability**

The appraisal system lack performance-based remuneration system. The system lacks incentives to improve and penalties for delays and failures. The security of service makes them lethargic and reduces creativity. This lack of accountability causes inefficiency and losses in the public enterprises.

**6. Under-Utilization of Capacity**

The public enterprises operate at less than their full capacity and produce lower than potential output. This increase the cost of production as the fixed cost is distributed over small output.

**Public Sector Reforms**

The Industrial policy resolution of 1956 has been the guiding factor which gave PSEs a strategic role in the economy. Massive investments have been made over the past five decades to build public sector. These enterprises have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in various areas. Initially, public sector investments were in the key infrastructure areas, but later on it begun to spread in all areas of he economy including non-infrastructure and non-core areas. Since 1980’s, the performance of state owned enterprises has been undergoing a close scrutiny in India. The existence of huge fiscal deficit made it difficult to raise funds at home and abroad. It was felt that the PSEs were absorbing a large chunk of government funds in the form of subsidies, which has resulted in the misallocation of resources brought about by diversion of savings. In order to overcome these problems government allows relaxation in the controls over PSEs and the emphasis was put on efficiency and internal resource generation of these enterprises. The public-sector reforms in India since 1991 involves structural changes that aim at increasing efficiency, decentralization, accountability and market orientation of these enterprises. The important reform measures introduced in the recent years are discussed as follows:

**1. Allowing Managerial Autonomy**

Government has adopted empowerment of PSEs as a continuous process. The management of PSEs has been given operational autonomy in respect of human resource development decisions like recruitment, promotion and other service related decisions. The profit-making enterprises which don’t depend on the budgetary support of the government identified as Navratnas and miniratnas are given enhanced powers to take investment and project -related decisions such as decisions relating to capital expenditure, raising capital from the market, mergers and acquisitions etc.  Board of Directors of PSEs exercises the delegated powers subject to the broad guidelines issued by Government. This would help PSEs to mitigate problems relating to delay in decision- making and help to improve the competitive strength of these enterprises.

**2. Performance-based Accountability through Memorandum of understanding (MOU) System**

MOU is an instrument that specifies mutual responsibilities of two parties who sign it. It is signed between government and management of PSEs.       MOU clarifies objectives and targets expected form the management and   performance evaluation takes place with reference to these objectives. Thus, it allows management by results and objectives rather than management by controls. Further an attempt is made to evaluate performance of PSEs on the basis of financial and operational performance indicators such as sales, growth in sales and return on assets, dividend pay-out ratio and earning per share.

**3. Manpower Rationalization**

PSEs for long have been suffering from over manning. Voluntary Retirement Scheme (VRS) has been introduced in a number of PSEs to shed the surplus manpower. In order to provide security net to those who opt for VRS, Counseling, Retraining and Redeployment (CRR) scheme has been launched. CRR aims at retraining employees who have opted for VRS so that the employees can adapt to new vocation after their separation from PSEs.

**4. Professionalism in Management**

In order to improve efficiency, Board of Directors (BOD) of PSEs has been strengthened with the induction of professional managers. The number of Government nominated directors has been reduced.  Management personnel are allowed greater operational autonomy in implementing the policies of the board.  Efforts are being made to reduce political and bureaucratic interference in the working of public sector enterprises.

**5. Dereservation**

The portfolio of the public-sector investments has been thoroughly reviewed to focus the public sector on strategic, high-tech and essential infrastructure. The new industrial policy 1991 adopted the policy of dereservation that allowed the entry of private sector in the activities exclusively reserved for public sector. The list of industries reserved solely for the public sector -- which used to cover 18 industries, including iron and steel, heavy plant and machinery, telecommunications etc. has been drastically reduced to two: atomic energy generation, and railway transport. These reforms mainly aim at providing competition to the public sector.

**6. Transparency in Operations of PSEs**

Corporate Governance Code has been formulated to bring greater amount of public accountability and transparency amongst PSEs in an era of competitive environment in 2005. Corporate governance refers to ethical business and transparent conduct of management of organization so as to protect the interest of stakeholders (i.e. shareholders, employees, suppliers etc.). These are the guidelines that management is required to follow in their decision-making process. The code meet the regulatory framework, builds harmonious relations with the stakeholders, provide high degree of accountability to the parliament and the public and ensures transparency in decisions. Further, PSEs are also subject to Right to Information Act (RTI).

**7. Revival and Restructuring of Sick PSEs**

Efforts are made to modernize and restructure PSEs and revive sick industries. The chronically sick industries have been sold off or closed. Companies having potential for revival have been allowed to be turned around by private sector. In 2004, Board for Reconstruction of PSE (BRPSE) has been created to take up restructuring and revival of PSEs. BRPSE is an advisory body which provides measures to strengthen, modernize PSEs. It advises government on disinvestment or closure or sale of chronically sick or loss making units that cannot be revived. It also monitors incipient sickness in PSEs so as to detect their problems at the initial stage that can result into sickness at the later stage. As on 15-7-07, 57 PSEs have been referred to BRPSE.

**8. Allowing PSEs to Enter Capital Market**

In an era of reduced budgetary support PSEs have been allowed to raise equity finance from the capital market. This has provided a market pressure on PSEs to improve their performance. As investors keep on monitoring the shares listed on stock exchange and market price movements reflect the performance of the company so management remain alert of their operational efficiency.  Further, the listing of PSEs share in the market has offered new opportunities to the investors that have also improved the trading activity of the stock exchanges in India. In the year 2007, 44 central PSEs were listed on the stock exchange. Some of PSE shares are enlisted on the international stock exchange (for example MTNL share is listed on New York stock exchange).

**9. Modernization**

The new policy provided for modernization of plants, rationalization of productive capacity and changes in the product mix of PSEs.  Further PSEs have been allowed to enter into technology joint ventures and have alliance to obtain technology and know-how. National Investment Fund has been established in 2005 to provide funds for revival and capital investment requirements of PSEs. The disinvestment proceeds will be channelized to this fund. This would help them to develop competitive strategy based on market needs.

**10. Disinvestment and Privatization**

Disinvestment in India primarily aims at improving corporate efficiency, financial performance and   competition amongst PSEs. It involves transfer of Government holding in PSEs to the private shareholders. Disinvestment introduces competition and market discipline on PSEs and depoliticizes the decision-making process.

**Industrial policies**

          The industrial policy means the procedures, principles, policies rules and regulations which control the industrial undertaking of the country and pattern of industrialization. It explains the approach of Government in context to the development of industrial sector. In India, the key objective of the economic policy is to achieve self-reliance in all sectors of the economy and to develop socialistic pattern of society. The industrial policy in the pre-reform period i.e. before1991 put greater emphasis on the state intervention in the field of industrial development.  These policies no doubt have resulted into the creation of diversified industrial structure but caused a number of inefficiencies, distortions and rigidities in the system. Thus, during late 70’s and 80’s, Government initiated liberalization measures in the industrial policy framework. The drastic liberalization measures were however, carried out in 1991.

Industrial Policies Prior to 1991

Industrial Policy Resolution, 1948

          The first important industrial policy statement was made in the Industrial Policy Resolution (IPR), 1948. The main thrust of IPR, 1948 was to lay down the foundation of mixed economy whereby the private and public sector was accepted as important components in the development of industrial economy of India. The policy divided the industries into four broad categories:

**(i) Industries with Exclusive State Monopoly:**  It included industries engaged in the activity of atomic energy, railways and arms and ammunition.

**(ii) Industries with Government Control:**It included the industries of national importance and so needs to be registered. 18 such industries were put under this category eg. fertilizers, heavy chemical, heavy machinery etc.

**(iii) Industries in the Mixed Sector:**It included the industries where private and public sector were allowed to operate. Government was allowed to review the situation to acquire any existing private undertaking.

**(iv)Industries under Private Sector:** Industries not covered by above categories fell in this category.

           IPR, 1948 gave public sector vast area to operate. Government took the role of catalytic agent of industrial development. The resolution assigned complementary role to small-scale and cottage industries. The foreign capital which was seen with suspect in the pre-independent era was recognized as an important tool to speedup up industrial development.

Industries (Development and Regulation) Act (IDRA), 1951

          IDRA, 1951 is the key legislation in the industrial regulatory framework. IDRA, 1951 gave powers to the government to regulate industry in a number of ways. The main instruments were the regulation of capacity (and hence output) and power to control prices. It specified a schedule of industries that were subject to licensing. Even the expansion of these industries required prior permission of the government which means the output capacity was highly regulated. The Government was also empowered to control the distribution and prices of output produced by industries listed in the schedule. The IDR Act gave very wide powers to the Government. This resulted in more or less complete control by the bureaucracy on the industrial development of the country.

The main provisions of the IDRA, 1951 were

a)  All existing undertakings at the commencement of the Act, except those owned by the Central Government were compulsorily required to register with the designated authority.

b)  No one except the central Government would be permitted to set up any new industrial undertaking “except under and in accordance with a license issued in that behalf by the Central Government.”

c)  Such a license or permission prescribed a variety of conditions, such as, location, minimum standards in respect of size and techniques to be used, which the Central Government may approve.

d)  Such licenses and clearances were also required in cases of ‘substantial expansion’ of an existing industrial undertaking.

Industrial Policy Resolution, 1956

           IPR, 1956 is the next important policy statement. The important provisions are as follows:

**(1) New classification of Industries:** IPR, 1956 divided the industries into the following three categories:

(**a) Schedule A industries:** The industries that were the monopoly of state or Government. It included 17 industries. The private sector was allowed to operate in these industries if national interest so required.

**(b) Schedule B industries:** In this category of industries state was allowed to establish new units but the private sector was not denied to set up or expand existing units e.g. chemical industries, fertilizer, synthetic, rubber, aluminum etc.

**(c) Schedule C industries:** The industries not mentioned in the above category formed pat of Schedule C. Thus, the IPR, 1956 emphasized the mutual existence of public and private sector industries.

**(2) Encouragement to Small-scale and Cottage Industries:** In order to strengthen the small-scale sector supportive measures were suggested in terms of cheap credit, subsidies, reservation etc.

**(3) Emphasized on Reduction of Regional Disparities:** Fiscal concessions were granted to open industries in backward regions. Public sector enterprises were given greater role to develop these areas.

          The basic rationale of IPR, 1956 was that the state had to be given primary role for industrial development as capital was scarce and entrepreneurship was not strong.  The public sector was enlarged dramatically so as to allow it to hold commanding heights of the economy.

Monopolies Commission

          In April 1964, the Government of India appointed a Monopolies Inquiry Commission “to inquire into the existence and effect of concentration of economic power in private hands.” The Commission looked at concentration of economic power in the area of industry. On the basis of recommendation of the commission, Monopolistic and Restrictive Trade Practices Act (MRTP Act), 1969 was enacted. The act sought to control the establishment and expansion of all industrial units that have asset size over a particular limit.

Industrial Policy Statement, 1973

          The Policy Statement of 1973 drew up a list of industries to be started by large business houses so that the competitive effort of small industries was not affected. The entry of competent small and medium entrepreneurs was encouraged in all industries. Large industries were permitted to start operations in rural and backward areas with a view to developing those areas and enabling the growth of small industries around.

Industrial Policy Statement, 1977

The main elements of the new policy were:

**1. Development of Small-Scale Sector:** The main thrust of the new industrial policy was an effective promotion of cottage and small industries. Government initiated wide-spread promotional and supportive measures to encourage small sector. The small sector was classified into 3 categories viz. Cottage and household industries which provide self-employment; tiny sector and small-scale industries. The purpose of the classification was to specifically design policy measures for each category. The policy statement considerably expanded the list of reserved items for exclusive manufacture in the small-scale sector.

**2. Restrictive Approach towards Large Business Houses:**The large-scale sector was allowed in basic, capital goods and high-tech industries. The policy emphasized that the funds from financial institutions should be made available largely for the development of small sector. The large sector should generate internal finance for financing new projects or expansion of existing business.

**3. Expanding Role of Public sector:** The industrial policy stated that the public sector would be used not only in the strategic areas but also as a stabilizing force for maintaining essential supplier for the consumer.

Further, the policy statement reiterated restrictive policy towards foreign capital whereby the majority interest in ownership and effective control should rest in Indian hands.

Industrial Policy, 1980

           The industrial policy 1980 emphasized that the public sector is the pillar of economic infrastructure for reasons of its greater reliability, for the large investments required and the longer gestation periods of the projects crucial for economic development. The IPR1956 forms the basis of this statement. The important features of the policy were:

**1. Effective Management of Public Sector:**

          The policy emphasized the revival of efficiency of public sector undertaking.

**2. Liberalization of Industrial licensing:**

          The policy statement provided liberalized measures in the licensing in terms of automatic approval to increase capacity of existing units under MRTP and FERA. The asset limit under MRTP was increased. The relaxation from licensing was provided for large number of industries. The broad-banding concept was introduced so that flexibility is granted to the industries to decide the product mix without applying for a new license.

**3. Redefining Small-Scale Industries:**

           The investment limit to define SSI was increased to boost the development of this sector. In case of tiny sector, the investment limit was raised to Rs.1 lakh; for small scale unit the investment limit was raised from Rs.10 lakh to Rs.20 lakh and for ancillaries from Rs.15 lakh to Rs. 25 lakh.

           Industrial policy, 1980 focused attention on the need for promoting competition in the domestic market, technological up gradation and modernization. The policy laid the foundation for an increasingly competitive export based industries and for encouraging foreign investment in high-technology areas.

Era of Liberalization after 80’s:

          After 1980, an era of liberalization started, and the trend was gradually to dilute the strict licensing system and allow more freedom to the entrepreneurs. The steps that were taken in accordance with the policy included:

**(i) Re-endorsement of licenses**: The capacity indicated in the licenses could be re-endorsed, provided it was 25 percent more than the licensed capacity (1984).

**(ii) Liberalization of 1990:**

The measures were as follows:

a)  Exemption from licensing for specific new units.

b)  Investment of foreign equity up to 40 percent was freely allowed.

c)  Location restrictions were removed.

Major Features of Pre-1991 Industrial Policy:

**1. Protection to Indian Industries:** Local industries were given shelter from international competition by introducing partial physical ban on the imports of products and high imports tariffs. Protection from imports encouraged Indian industry to undertake the manufacture of a variety of products. There was a ready market for all these products.

**2. Import-Substitution Policy:** Government used its import policy for the healthy development of local industries. Barring the first few years after Independence, the country was facing a shortage of foreign exchange, and so save scarce foreign exchange imports-substitution policy was initiated i.e.   Government encouraged the production of imported goods indigenously.

**3. Financial Infrastructure:**  In order to provide the financial infrastructure necessary for industry, the Government set up a number of development banks. The principal function of a development bank is to provide medium and long-term investments. They have to also play a major role in promoting the growth of enterprise. With this objective, Government established the Industrial Finance Corporation of India (IFCI) (1948), Industrial Credit and Investment Corporation of India (ICICI) (1955), Industrial Development Bank of India (IDBI) (1964), Industrial Reconstruction Corporation of India (1971), Unit Trust of India (UTI) (1963), and the Life Insurance Corporation of India (LIC).

**4. Control over Indian Industries:** Indian industries were highly regulated through legislations such as Industrial licensing, MRTP Act, 1969 etc. These legislations restricted the production, expansion and pricing of output of almost all kinds of industries in the country.

**5. Regulations on Foreign Capital under the Foreign Exchange and Regulation Act (FERA):** FERA restricted foreign investment in a company to 40percent. This ensured that the control in companies with foreign collaboration remained in the hands of Indians. The restrictions were also imposed on technical collaborations and repatriations of foreign exchange by foreign investors.

**6.  Encouragement to Small Industries:** Government encouraged small-scale industries (SSIs) by providing a number of support measures for its growth.  Policy measures addressed the basic requirements of the SSI like credit, marketing, technology, entrepreneurship development, and fiscal, financial and infrastructural support.

**7.  Emphasis on Public Sector:** The Government made huge investments in providing infrastructure and basic facilities to industries. This was achieved by establishing public sector enterprises in the key sectors such as power generation, capital goods, heavy machineries, banking, tele- communication, etc.

Review of Pre-1991 Industrial Policy

           The pre1991 industrial policies created a climate for rapid industrial growth in the country. It has helped to create a broad-base infrastructure and basic industries.   A diverse industrial structure with self-reliance on a large number of items had been achieved. At the time of independence, the consumer goods industry accounted for almost half of the industrial production. In 1991, such industries accounted for only about 20 percent. In contrast capital goods production was less than 4 percent of the total industrial production. In 1991, it had gone up to 24 percent. Industrial investment took place in a large variety of new industries. Modern management techniques were introduced. An entirely new class of entrepreneurs has come up with the support system from the Government, and a large number of new industrial centers have developed in almost all parts of the country. Over the years, the Government has built the infrastructure required by the industry and made massive investments to provide the much-needed facilities of power, communications, roads etc. A good number of institutions were promoted to help entrepreneurship development, provide finance for industry and to facilitate development of a variety of skills required by the industry.

           However, the implementation of industrial policy suffered from shortcomings. It is argued that the industrial licensing system has promoted inefficiency and resulted in the high-cost economy. Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, due to considerable discretionary powers vested in the licensing authorities the system tended to promote corruption and rent-seeking. It resulted into pre-emption of entry of new enterprises and adversely affected the competition. The system opposite to its rationale favored large enterprises and discriminate against backward regions. Government announced a number of liberalization measures in the industrial policy of 1970, 1973 and 1980. However, the dramatic liberalization efforts were made in the industrial policy, 1991.

New Industrial Policy, 1991

          India’s New Industrial Policy announced in July 1991 (hereafter NIP) was radical compared to its earlier industrial policies in terms of objectives and major features. It emphasized on the need to promote further industrial development based on consolidating the gains already made and correct the distortion or weaknesses that might have crept in, and attain international competitiveness. (Ministry of Industry, 1991).  The liberalized Industrial Policy aims at rapid and substantial economic growth, and integration with the global economy in a harmonized manner. The Industrial Policy reforms have reduced the industrial licensing requirements, removed restrictions on investment and expansion, and facilitated easy access to foreign technology and foreign direct investment.

Pre-vs. Post 1991 Policy

1. **Distinctive Objectives of New Industrial Policy (NIP), 1991**:

 NIP had two distinctive objectives compared to the earlier industrial policies:

**i) Redefinition of Concept of Self-Reliance:** NIP redefined the concept of economic self-reliance. Since 1956 till 1991, India had always emphasized on Import Substitution Industrialization (ISI) strategy to achieve economic self-reliance. Economic self-reliance meant indigenous development of production capabilities and producing indigenously all industrial goods, which the country would demand rather than importing from outside. The goal of economic self-reliance necessitated the promotion of ISI strategy. It helped to build up the vast base of capital goods, intermediate goods and basic goods industries over a period of time. NIP redefined economic self-reliance to mean the ability to pay for imports through foreign exchange earnings through exports and not necessarily depending upon the domestic industries.

**ii) International Competitiveness**: NIP emphasized the need to develop indigenous capabilities in technology and manufacturing to world standards. None of the earlier industrial policies, either explicitly or implicitly, had made reference to international technology and manufacturing capabilities in the context of domestic industrial development (Ministry of Commerce and Industry, 2001). For the first time, NIP explicitly underlined the need for domestic industry to achieve international competitiveness.

          To achieve these objectives, among others, NIP initiated changes in India’s industrial policy environment, which gained momentum gradually over the decade. The important elements of NIP can be classified as follows:

1. Public sector de-reservation and privatization of public sector through dis-investment;

2. Industrial Delicensing;

3. Amendments of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969;

4. Liberalized Foreign Investment Policy;

5. Foreign Technology Agreements (FTA);

6. Dilution of protection to SSI and emphasis on competitiveness enhancement.

**1. Public Sector De-Reservation and Privatization through Dis-Investment:**

           Till 1991, Public Sector was assigned a pre-eminent position in Indian Industry to enable it to achieve “commanding heights of the economy” under the Industrial Policy Resolution (IPR), 1956.  Accordingly, areas of strategic importance and core sectors were exclusively reserved for public sector enterprises. Public enterprises were accorded preference even in areas where private investments were possible.

Since 1991, the public-sector policy consists of:

**(i)  Reduction in the number of industries reserved for public sector:** Now only two industries (atomic energy and railway transport) are reserved for the Public Sector. They are known as “Annexure I” industries (Ministry of Commerce and Industry, 2001). The essence of government’s Public Sector Undertakings (PSUs) policy since 1991 has been that government should not operate any commercial enterprises. The policy emphasized to bring down government equity in all non-strategic PSUs to 26 percent or lower, restructure or revive potentially viable PSUs, close down PSUs, which cannot be revived and fully protect the interests of workers. Government’s withdrawal from non-core sectors is indicated on considerations of long-term efficient use of capital, growing financial un-viability and the compulsions for these PSUs to operate in an increasingly competitive and market oriented environment (Disinvestment Commission, 1997).

**(ii) Implementation of Memorandum of Understanding (MOU):** As a part of the measures to improve the performance of public enterprises, more and more of public sector units have been brought under the purview of Memorandum of Understanding (MoU) system. A memorandum of understanding is a performance contract, a freely negotiated document between the Government and a specific public enterprise.

**(iii)   Referral to BIFR:** Many sick public sector units have been referred to the Board for Industrial and Financial Reconstruction (BIFR) for rehabilitation or, where necessary, for winding up.

**(iv)  Manpower Rationalization:** In order to make manpower rationalization Voluntary Retirement Scheme (VRS) has been introduced in a number of PSUs to shed the surplus manpower.

**(v) Private Equity Participation:** PSUs have been allowed to raise equity finance from the capital market. This has provided market pressure on PSUs to improve their performance.

**(vi)  Disinvestment and Privatization:** Disinvestment and privatization of existing PSUs has been adopted to improve corporate efficiency, financial performance and competition amongst PSUs. It involves transfer of Government holding in PSUs to the private shareholders.

**2. Industrial Delicensing:**

          The removal of licensing requirements for industries, domestic as well as foreign, commonly known as “de-licensing of industries” is another important feature of NIP. Till the 1990s, licensing was compulsory for almost every industry, which was not reserved for the public sector. This licensing system was applicable to all industrial enterprises having investment in fixed assets (which include land, buildings, plant & machinery) above a certain limit. With progressive liberalization and deregulation of the economy, industrial license is required in very few cases. Industrial licenses are regulated under the Industries (Development and Regulation) Act 1951. At present, industrial license is required only for the following:

(i)   Industries retained under compulsory licensing (five industries are reserved under this category).

(ii) Manufacture of items reserved for small scale sector by larger units: An industrial undertaking is defined as small scale unit if the capital investment does not exceed Rs. 10 million (approximately $ 222,222). The Government has reserved certain items for exclusive manufacture in the small-scale sector. Non-small-scale units can manufacture items reserved for the small-scale sector if they undertake an obligation to export 50 percent of the production after obtaining an industrial license.

(iii) When the proposed location attracts locational restriction: Industrial undertakings to be located within 25 kms of the standard urban area limit of 23 cities having a population of 1 million as per 1991 census require an industrial license.

          Thus, excluding these, investors are free to set up a new industrial enterprise, expand an industrial enterprise substantially, change the location of an existing industrial enterprise and manufacture a new product through an already established industrial enterprise. The objective of industrial delicensing would be to enable business enterprises to respond to the fast-changing external conditions. Entrepreneurs will be free to make investment decisions on the basis of their own commercial judgment. This will facilitate the technological dynamism and international competitiveness. Further industries will have freedom to take advantage of ‘economies of scale’ as well as ‘economies of scope’ in the current industrial policy environment.

1. **Amendment of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969:**

An important objective of India’s earlier industrial policies was to prevent emergence of private monopolies and concentration of economic power in a few individuals. Accordingly, Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 was enacted and MRTP Commission was set up as a permanent body to periodically review industrial ownership, advice the government to prevent concentration of economic power, investigate monopolistic trade practices and inquire into restrictive trade practices, which are prejudicial to public interest. An MRTP firm was mainly defined in terms of asset size. An MRTP company had to obtain prior approval of the government for setting up a new enterprise as well as for expansion. However, MRTP Act was applicable only to private sector companies.

          Since 1991 MRTP Act has been restructured and pre-entry restrictions have been removed with regard to prior approval of the government for the establishment of a new undertaking, expansion, amalgamation, merger, take over, and appointment of directors of companies. The asset restriction and market share for defining an MRTP firm has been done away with. MRTP Act is now applicable to both private and public sector enterprises and financial institutions. Today only restrictive trade practices of companies are monitored and controlled. The MRTP act has been replaced by the Competition Act, 2002.  This law aims at upholding competition in the Indian market. The competition commission has been established in 2003 which mainly control the practice that have an adverse impact on competition.

**4. Liberalized Foreign Investment Policy:**

           India’s earlier industrial policies welcomed FDI but emphasized that ownership and control of all enterprises involving foreign equity should be in Indian hands. The Balance of Payments (BoP) difficulties in the mid-1960s forced the country to adopt a more restrictive approach towards FDI through the setting up of a Foreign Investment Board, which classified industries into two groups: banned and favored for foreign technical collaboration and FDI. The number of industries for foreign investment was steadily narrowed down and by 1973 there were only 19 industries where FDI was permitted (Kucchal, 1983). The enactment of FERA, 1973 marked the beginning of the most restrictive phase of India’s foreign investment policy.  The NIP radically reformed foreign investment policy to attract foreign investment. The important foreign investment policy measures are as follows:

**i)  Repeal of FERA, 1973:** FERA, 1973 has been repealed and Foreign Exchange Management Act (FEMA) has come into force with effect from June 2000 (RBI, 2003). Investment and returns can be freely repatriated except where the approval is subject to specific conditions such as lock-in period on original investment, dividend cap, foreign exchange neutrality, etc. as specified in the sector specific policies. The condition of ‘dividend balancing’ was withdrawn for dividends declared. A foreign investor can freely enter, invest and operate industrial enterprises in India,

**ii)  Dilution of Restrictions on Foreign Direct Investment (FDI):** FDI is allowed in all sectors including the services sector except atomic energy and railway transport. FDI in small scale industries is allowed up to 24 percent equity. Use of brand names/trademarks is allowed.  Further, FDI up to 100 percent is allowed under the automatic route in all activities/sectors except the following which require prior approval of the Government: -

* Sectors prohibited for FDI;
* Activities/items that require an industrial license;
* Proposals in which the foreign collaborator has an existing financial/technical

collaboration in India in the same field;

* Proposals for acquisitions of shares in an existing Indian company in financial service sector and where Securities and Exchange Board of India (substantial acquisition of shares and takeovers) regulations, 1997 is attracted;
* All proposals falling outside notified sectoral policy/CAPS under sectors in which FDI is not permitted.

Thus, most of the sectors fall under the automatic route for FDI.

**5. Foreign Technology Agreement**

           The automatic approvals for technology agreement are allowed to industries within specified parameters. Indian companies are free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgment.

**6. Dilution of Protection to Small Scale Industries (SSI) and Emphasis on Competitiveness:**

SSIs enjoyed a unique status in Indian economy due to its diversified presence across the country and thereby utilizing resources and skills, which would have otherwise remained unutilized. Due to their potential to generate large-scale employment, produce consumer goods of mass consumption, alleviate regional disparities, etc., industrial policies protected the sector for its growth. The principal protective measures for SSI comprised: (i) Demarcating SSI from the rest of industry through a definition under the IDR Act, 1951, (ii) Concessional credit from the banking system, (iii)Fiscal concessions, (iv) Exemption from industrial licensing and labor legislations, (v) Preferential access to scarce raw materials, both domestic and imported, (vi) Market support from the government through reservation of products for government purchase and price preferences, and (vii) Reservation of products for exclusive manufacturing in SSIs and restrictions on the growth of output and capacity in the large-scale sector for products reserved for SSI manufacturing. These policy measures protected SSIs from both internal and external competition.

           However, since 1991 the protective emphasis of SSI policy has undergone dilution. In August 1991, government of India brought out an exclusive policy for SSI. The policy marked: (i) the beginning of an end to protective measures to small industry and (ii) promotion of competitiveness by addressing the basic concerns of the sector namely technology, finance and marketing. Subsequently, the number of items reserved exclusively for small industry manufacturing has been gradually brought down.  This policy has lost its relevance to a large extent because though these products could not be manufactured by large enterprises domestically, they can be imported from abroad due to the removal quantitative and non-quantitative restrictions on most imports by April 1, 2001 (Ministry of Finance, 2002). Concession element in lending rates for small industry has been largely withdrawn during the 1990s (RBI, 2003). The number of products reserved exclusively for purchase from small industry by the government has been reduced to 358 items from 409 items.  Measures have been adopted to improve technology and export capabilities of SSIs. Thus the overall promotion orientation of SSI has shifted from protection towards competitiveness.

Impact of Industrial Policy, 1991

          The all-round changes introduced in the industrial policy framework have given a new direction to the future industrialization of the country. There are encouraging trends on diverse fronts. Industrial growth was 1.7 per cent in 1991-92 that has increased to 9.2 percent in 2007-08.The industrial structure is much more balanced. The impact of industrial reforms is reflected in multiple increases in investment envisaged, both domestic and foreign. This is due to encouraging response from the private sector. There has been dramatic increase in FDI since 1991. The foreign investment as a percentage of total GDP has increased from 0.5 percent in 1990-91 to 5.7 percent in 2006.Investments in infrastructure sector such as power generation have surged from players of various sizes in different states. The capital goods have grown at an accelerated pace, over a high base attained in the previous years, which augurs well for the required industrial capacity addition.

Conclusion

           The Government policies and procedures in the pre-1991 period aimed at industrial development of the country, but the enactment of the IDR Act, procedures laid down for obtaining industrial licensing and various rules acted as a great deterrent to the growth of industries in the country. The bureaucracy acquired unprecedented powers and authority over all kinds of industrial activities. The NIP announced in July 1991, unshackle the industries from the cobweb of bureaucratic control to allow it to achieve international competitiveness. NIP encouraged foreign investment in the economy and opened it to greater domestic and international competition.

**Introduction to private sector**

Despite the important role played by the public sector in India, the contribution of private sector to overall growth was always higher than public sector because of its significantly higher share in GDP. The importance of private sector can be assessed in terms of its share in domestic saving and gross domestic capital formation.  The gross domestic savings and gross domestic capital formation of private sector accounts for around 25 percent and 18 percent respectively of total GDP at market price. The plan wise statistics depicts that private sector dominates the savings and capital formation in the economy. Under the new economic policy, the private sector has become more preponderant than public sector.

Profile of Private Sector in India

**Considerable Growth**

Over the years in the past since independence, the private sector has grown rapidly. There has been an impressive accretion in the number of persons employed, value of output produced and the extent of national income generated. The share of private sector is dominant in agriculture, forestry, fishery and small-scale industries. Though the share of private sector in the heavy industries is not significant but in the recent years an uptrend is witnessed. Further the private sector has grown faster as a result of the FDI liberalization measures, industrial delicensing and external demand boost from devaluation.

**Diversified Structure**

The private sector in India has a diversified product profile i.e. private sector encompasses a large variety of industries scattered all over the country.

**Reasonably Profitable**

The private sector has shown profitability greater than its public counterparts. Further the sale, production and investment growth in the private sector exceeds that of public sector.

Shortcomings and Limitations of Private Sector

Private sector though has depicted a spectacular growth profile but it suffers from the limitations discussed as follows:

**1) Unhealthy Working:** Barring few exceptions, private sector in India often indulge in unfair business practices of generation of black-economy and corrupt business dealings like evasion of tax, charging higher prices for goods, creating artificial scarcity of Goods etc. A series of capital market scams by big corporate and cooperative banks has brought into sharp focus the need for improvement of regulation of private sector.

**2) Lack of Social Orientation**: Private sector is motivated towards short-term gain and often fails to maximize production of essential goods. Private sector has been extremely cautious to venture into innovative products and processes.

**3) Slow Progress in R&D:** The private sector has been hesitant to invest in the research and development of technology. Huge public investments are made in the universities and research institutes by the government. The commercial behavior guide the investment and funding of research projects.

**4) Monopoly and Concentration of Power:** The restrictive production policies and charging of higher price have resulted in monopoly gains to the private sector. The policy of mergers, acquisition has been used to prevent competition in the industry. The increased foreign investment that targets the small domestic industry to enter the domestic market has further aggravated the problems of concentration of economic wealth in the hands of few.

**5) Industrial Unrest:** The labor unrest is quite alarming in the private sector especially amongst small scale and medium-sized enterprises. The wages in these enterprises are quite low and there exists adverse working condition. The industrial disputes are quite high as compared to the public sector. This often results into strikes, lockouts, gheraos etc. The harmful consequences are obvious: work stoppage leading to the non-utilization of capital equipment, idle labor, resulting in the wastage of economic resources.

**6) Sickness:** The large number of total unit in the private sector is either sick or prone to become sick. The sickness is the result of many problems such as bad management, old production methods, outdated technology, inadequate capital and labor unrest.

Suggested Measures

The focus of post-reform policy in India has been to attract private investments in expanding India’s infrastructure, which would catalyze the economic growth and poverty reduction. The public sector has been allowed to focus on few strategic areas. However, the results of these reforms measures have been mixed. Existing imperfections system has constrained the projects in the private sector. The following measures are suggested to improve investment climate for the private sector in India:

**1. Better Public Administration and Governance:**Poor governance in the government departments has had adverse impacts on India’s private sector. Public bodies such as state electricity boards (SEBs), Municipal bodies and others have a poor governance record manifest in the form of poor record keeping, lack of integrity in accounting, information delayed, employee indiscipline, etc., which severely restricts their ability to contract with the private sector. Thus, the private participation in the infrastructure development is inhibited.

**2. Competition Policy:** Excessive regulation of entry and exit from business relative to most countries is a key factor contributing to less competitive markets in India. This has resulted in lower private foreign investments in the country.

**3. Legal and Judicial Reform:** Legal delays and uncertainty on property rights, speed of the courts, inadequacy of bankruptcy and foreclosure laws, inflexibility of labor laws significantly increase risk perception and consequent costs to the private sector.

**4. Infrastructure Development and Reforms:** By most standards, and in all sectors, delivery of infrastructure services has lagged behind demand mainly due to the tremendous increase in population, accelerating urbanization and faster India’s industrial growth. The delays, cost overruns, and lack of competitiveness results in the slow growth of basic infrastructure facilities. The infrastructure development would improve the investment climate for the private sector in India.

Though considerable progress has been made in increasing the role of the private sector in the economy, significant investment potential could be unleashed if key reforms are initiated in the energy sector and the financial health of the public utilities that will transact with the private sector is improved.

Public vs. Private Sector in the Post Liberalized Period

The public sector in India has played a significant role in the overall development of the economy. The reform process has redefined the role of public sector to focus on strategic areas which are considered essential for accelerating economic growth. The public sector will focus on the regulatory aspects so as to allow the smooth operations of competitive markets.  Further, government is expected to play a greater role in the development of social and physical infrastructure in the country. The role of private sector has increased tremendously in the areas which have a scope of competitive markets. Strengthening the private sector’s capability is also an important need. This could be achieved through enhancing their capital base and widening the range of debt instruments available in the market. Supporting deserving projects through insurance and guarantee products would moderate the risk profile of the projects and improve the private participation in the infrastructure sector.

The purpose for which PSEs are set up is primarily for the welfare of both the workers and the society. They have been assigned the important role of achieving our national objective of economic growth with social justice, generating larger social gains and strengthening country’s economy by removing regional disparities and promoting balanced development in different parts of the country.

Hence, the performance of the public-sector enterprises cannot be evaluated in terms of the criteria used to judge the performance of private sector enterprises and these have been formed for welfare maximization instead of profit maximization and hence their role should be focused accordingly.