ISSN: 2456–5474 RNI No.UPBIL/2016/68367 Vol.-5* Issue-11* December- 2020
Innovation The Research Concept

A Critical Analysis of Disinvestment in Bharat Petroleum Corporation Limited Future Financial Performance and Impact on Indian Economy

Paper Submission: 15/12/2020, Date of Acceptance: 26/12/2020, Date of Publication: 27/12/2020

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Abstract

On November 20, 2019 Cabinet Committee on Economic Affairs (CCEA) chaired by the Prime Minister Shri Narendra Modi approved disinvestment in 5 Central Public Sector Enterprises (CPSEs) including Bharat Petroleum Corporation Limited (BPCL)- a profitable government company. The decision of selling all the government stack in BPCL through strategic sale has brought on much criticism, as post disinvestment benefit is lesser than its benefits to Indian economy if the government continues its ownership. This paper attempts test its truism. For this sake we compare the future financial performance of BPCL if it is privatized with the future financial performance if it is not privatized. This is worked out using linear regression model with intercept and linear regression model without intercept to estimate the future financial performance under the both of the case. To check the argument of the bad repercussion of the decision on Indian economy we estimated the fiscal deficit under both the cases using weighted average mean taking the base of estimations presented in the Union Budget 2020-21.

The results show that BPCL will perform well under the government ownership in the terms of profitability and efficiency. BPCL can perform well under private ownership only if it rises its product price or by reducing the work force size. The fiscal deficit is lower for the fiscal year 2020-21 if BPCL is privatized, but this benefit is only of the short term in the nature. The government has to give up the dividend revenue from BPCL if it is privatized which will effect negatively to more than one fiscal years. Empirical data shows government can generate more disinvestment revenue through the SIP but its process is more time consuming. The other reason why government should choose SIP method is that it will help Indian capital market on the other hand strategic sale method will is beneficial to only one entity- the buyer (and in the situation of 'Winner Curse 'it will not benefit the buyer too).

Our study recommends, rather than privatizing BPCL- a profitable CPSE- government should privatize any other loss making CPSE to unblock the resources, divert them to productive activities and increase the efficiency in the loss making CPSE by handing over them to the private owners.

Keywords: Bharat Petroleum Corporation Limited, Central Public Sector Enterprise, Disinvestment, Privatization, Indian Economy, Financial Analysis

Introduction

At the time of independence, all the business activities was carried out by private sector but Jawaharlal Nehru government (1947-1964) gave more importance to heavy industries and established government companies for their business expansion. At the same time government reserved some industries only for government companies and regulated many industries. The main objectives for establishment of PSUs are to generate financial resources for the government; to redistribute income and wealth; to create employment opportunities; to promote export and import substitution. That is why many authors termed PSUs as engine of economic growth. But it should also be noted that overburdened with social obligations, most of the PSUs were failed to generate desired profit in comparison to their counterparts private sector companies. The bias of survivorship is one of the reasons behind the poor performance of PSUs in comparison with private sector companies. Towards the end of 1990s, government realized that the main function of the government is to concentrate on social and physical infrastructure and not to be in the business. In 1991, P. V. Narsimha Rao government (1991 - 1996) announced many economic reforms and privatization was one of them. As Disinvestment Commission under G. V. Ramkrishna guided that disinvestment should be for straightening PSUs and not for dismantling PSUs. The commission also advised that the receipt should not be used for government revenue expenditure as the Modi government planning to quickly sell off the assets of BPCL to bridge tax revenue short fall in economic slowdown.[1]

The liberalisation reforms undertaken in 1991 ushered for privatization/disinvestment of PSUs. this was done through the sale of minority stake in bundles through auction. This was followed till 1999-2000. Subsequently, sale of substantial portion of Government shareholding like sale of 74 per cent of the Government's equity in Modern Food Industries Limited (MFIL). Thereafter, 12 PSUs (including four subsidiaries of PSUs), and 17 hotels of Indian Tourism Development Corporation (ITDC) were sold to private investors along with transfer of management control by the Government. In addition, 33.58 per cent shareholding of Indo Bright Petroleum (IBP) strategically sold to Indian Oil Corporation (IOC). IBP, however, remained a PSU after this strategic sale, since IOC held 53.58 per cent of its paid-up equity. Another major shift in disinvestment policy was made in 2004-05 when it was decided that the government may "dilute its equity and raise resources to meet the social needs of the people", a distinct departure from strategic sales. Strategic Sales have got an attractive push after 2014. During 2016-17 to 2018-19, on average, strategic sales accounted for around 28.2 per cent of total proceeds from disinvestment. in this line we picture out the current position of BPCL.

BPCL has market share of 23.83% in the petroleum industry. It has market sales (including exports) is 44.98 Million Metric Tonne (MMT) and total revenue Rs 3,40,606.13 Crore including revenue from operations Rs 3,37,622.53. Its Gross profit before depreciation, interest and tax is Rs 14,948 Crore and Profit after tax (PAT) is Rs 7,131 Crore. Total number of man power employed in then BPCL is 11,971. Total number of retail outlets is 14,802. As on 31st December 2019, the market capitalization of BPCL was Rs 106,619 Crore ($ 15 Billion). The Central Government is presently holding 1,15,60,95,962 Shares which is 52.98% of the total shares.(The table-1 is showing the distribution of Shareholding as on 31st December, 2019) BPCL Trust for Investment in Shares holds 20,23,72,422 equity shares i.e. 9.33% (treasury shares) for the benefit of BPCL. It is possible that these shares may be retained, cancelled or disposed prior to the transaction; and correspondingly the total number of outstanding shares / capital structure may change. However, the number of shares to be sold in the Proposed Transaction shall remain the same.[2]

On November 20, 2019 CCEA chaired by Prime Minister Shri Narendra Modi approved strategic disinvestment in 5 CPSEs including 52.98% stack in BPCL - one of the Maharatna PSUs stating two benefits: first - the unlocked resources will be utilized in financing social sectors/ developmental programmes which will benefit the public; second - the strategic buyer/ acquirer may bring in new management/ technology/ investment for the growth of these companies and may use innovative methods for their development.[3] This strategic disinvestment will also generate revenue to meet targeted fiscal deficit of 3.4% [4] of gross domestic product (GDP) for the financial year 2019-20 which is otherwise difficult to achieve amidst the economic slowdown. Move to privatize is not the first time that government is approving disinvestment in profitable PSUs, In 2 bruary 2002, Atal Bihari Vajpayee government (1998 - 2004) also tried to privatize BPCL but the Supreme Court of India mandated parliamentary approval for the disinvestment in the oil distribution business in its judgment on September 16, 2003 [5] as the executive action for disinvestment was contrary to the provisions of the laws that had nationalized these companies.[6]

Table: 1, Equity Capital Structure of BPCL

Particulars	No. of Shares (Rs Crore)	Equity Share Capital (RS Crore)
Authorized	263.5	2,635.00
Issued, subscribed and paid-up	216.925	2,169.25

Source: Annual Report for FY 2018-19

Table:2, Distribution of Shareholding as on 31st December, 2019

Table 1.1: Equity Capital Structure of BPCL

Shareholder	No. of Shares Held	% of holding
Government of India	1,14,91,83,592	52.98
Foreign Portfolio Investors	30,51,24,402	14.07
Mutual Funds / UTI	24,81,73,349	11.44
BPCL Trust for Investments in Shares	20,23,72,422	9.33
Insurance Companies	1,50,156,822	6.92
Individual Investors (Shareholding upto of Rs 2 Lakh)	50,67,88,989	2.34
Bodies Corporate	2,66,61,648	1.23
Government of Kerala	1,86,66,666	0.86
Individual Investors (Shareholding in excess of Rs 2 Lakh)	94,59,061	0.44
Clearing Members	36,14,699	0.17
Non Residential Indians	28,26,681	0.13
Financial Institutions / Banks	23,34,504	0.11
Total	2,16,92,52,744	100

Source: Public Disclosure Published on BPCL Website

But in May, 2016 government introduced the Repealing and Amending Act, 2016 and repealed the entire legal roadblock so now it is possible for the government to privatize BPCL with executive action. The below tables 1 & 2 show the Equity capital structure and distribution of shareholding of BPCL.

The rest of the structure of the study is as follows. Section two presents the literature review on disinvestment and procedure of privatization both at global and national levels. Whereas the third section deals with the data source and methodology, and the fourth section present the results and discussion. Finally, the fifth section concludes the research outcomes.

Review of Literature

This section of the research deals with the summery of past studies both at global and national level. Many studies have been undertaken at global level to study about outcome of the privatization. Some of the studies like Rehman Sobhan[7] (2002) conducted a study on privatization in Bangladesh. The study evaluated the performance of privatization for two decades; the research outcome reveals that there have been fewer benefits, majority with low performance, either contributed to closing down the enterprises or let to job losses. Shahzad Uddin and Trevor Hopper[8] in their work on accounting for privatization in Bangladesh attempted to check Bangladesh's privatization with world banks claim on privatization. The World Bank claimed that privatization succeeded in achieving commercial success and societal return. Whereas the research report of Shahzad Uddin and Trevor Hopper suggests that privatization has marginalized the return to the society, declined the state revenue in real terms and as a proportion of value added. Moreover it only created wealth to new owners. Wen Xu and Shahzad Uddin (2008) in their article on the topic "Public sector reforms, privatization and regimes of control in a Chinese enterprise" examines the rationale behind the Chinese Government's privatization and public sector reforms. They found out that reformed state enterprises and privately managed firms bring forth superior management control and better performance, increase investment, productivity, efficiency promote economic growth and create jobs. At the same time the paper also reveals that a falling tendency in employment, skewed distribution of wealth, lack of accountability among private companies. Douglas Wood and Devendra Kodwani (1997) conducted a study on "Privatisation Policy and Power Sector Reforms: Lessons from British Experience for India". Through their study they rationalized that privatization brings radical change in the industrial structure and restructuring of firms with tight regulatory framework intended to promote efficiency and competition.

Nandini Gupta[9] (2006) in her research on "privatization in south Asia" in reference to India highlighted that public support for privatization is low. There are two types of privatization partial and strategic sales. The partial privatization is politically less costly because it retains the management control whereas strategic sales fetch more efficiency however this is political costly to implement. The paper also states privatization in Pakistan and Bangladesh have reaped more benefits than in India. Siddhartha G. Dastidar, Raymond Fisman and Tarun Khanna[10] (2007) worked on "Testing limits to policy reversal: Evidence from Indian Privatizations". Their research reveals that stock prices of government-controlled companies planned for privatization dropped 3.5% in comparison to private firms. Gopal Joshi[11] (1999) in his research on "Privatization in India: Social Effects and Restructuring" says that privatization will minimize the social costs. Sunita Kikeri and Aishetu Fatima Kolo (2005) conducted a study on "privatization: Trends and Recent Developments" for the developing countries. The results show that the costs of not privatization are high. Simrit Kauri[12] (2004) in his research paper on "Privatization and Public enterprise reform: a suggestive action plan for India" denotes that privatization during Globalised period is said to be in a proper direction.

Apart from the above cited studies at global level there are few studies done at national level. Some of the researchers have endeavored namely Manju Gupta, P. Saxena and S.P. Kaushik (2002) in their work on "Accounting standards Vs Accounting Practices in Indian Public Sector" for 36 manufacturing Public Sector units were analyzed. They found that public sector units lacked significant progress and awareness in choosing apt accounting standard. If PSU choose proper accounting standard then it can maximize the confidence of investors in the PSUs. V. Gangadhar and M. Yadagiri (2002) conducted a study on "Disinvestment in public sector enterprise" for the period of 1991-2001. In which they recommended that disinvestment should not be meager but it should be to the extent of 10 to 20% of the equity of 23 selectively listed PSUs to get the benefit of targeted disinvestment plan. Anurag[13] (2007) studied the 'disinvestment of public sector undertaking' during 1991 to 2002. The research identified that out of 48 companies disinvested only a few are genuinely privatized. In terms of policy, promise and performance India lacked as compared to Thailand, Philippines, Korea, Turkey and Eastern Europe in disinvestment. K.N. Naik in his case study on 'IPCL Takeover by RIL- Cultural shock of Takeover of Public sector by private Sector' reveals that the takeover by RIL was a rude cultural shock to employees who had their root in the IPCL. Jain P. K. Yadav & Gupta Seema conducted a study on the impact of disinvestment on financial performance for 15 Indian PSU of petroleum industry for the period of 1997-2007. In their research they used profit test to access the economic efficiency and rate of return to determine the profitability. The result revealed positive yield of disinvestment. T.T.Ram Mohan undertook a research on privatization in India and its impact on Indian economy. He finds out that privatization improved profitability, efficiency, employment, output, capital spending and net taxes in privatized firms. Further he stated that better performance depends on the degree of disinvestment. Himanshu Joshi (2008) worked on to know whether disinvestment improves financial performance for Bharat Heavy Electricals Ltd. He notices improvement in profitability of the firm after disinvestment while negative dividend payment. Very few literature reviews coated above directly deal with the financial performance of privatized PSU. This enables to conduct an analyses on the present effort to privatize BPCL.

Objective of the Study

The followings are the objectives for the study:

1. To critically analyze the decision of privatizing BPCL.
2. To judge whether the privatization in BPCL will improve its financial performance or not.
3. To assess whether the privatization in BPCL will help in meeting fiscal gap in the economy.
4. To offer remedial suggestions, if any, as the study may warrant.

Hypothesis

The followings are the null hypothesis for the study:

1. Privatization of profit making CPSE like BPCL is not justified.
2. Privatization does not ensure better financial performance.
3. Privatization is not a desirable step to meet fiscal gap.

Data Source and Methodology

The data for the research objectives taken from Annual Financial Reports of the Company, Union Budget 2020-21,stock exchange Supreme Court of India, BPCL, Department of Investment and Public Asset Management and PIB, the research work considers future financial data for the period from 2019-20 to 2022-23 in order to estimate this data is extrapolated for the last 11 years. The extrapolation is done with 'Liner Regression Model with and without Intercept'. Future data in case of 'if BPCL is not privatized is derived simply from extrapolating last 11 years data (from 2008-09 to 2018-19) with both the regression model; but in case of 'if BPCL is privatized the future data relating to the company is derived by replicating the slope of the trend line of Reliance Industries Limited (RIL) to the BPCL (for regression model without intercept) and replicating the slop of the trend line of RIL to the BPCL without changing intercept of the trend line of the BPCL. The reason to take RIL data as the base is that, RIL is the public company with nearly zero per cent government stack in the same segment, so we can get clear idea about the fully privatized BPCL for the future. The prediction is made for the next three years. For predicting future data with regression model, weighted average of the data (data from the 2008-09 to the previous year) is assumed as predictor or independent variable, and the current year data is assumed as prediction or dependent variable.

For determining the possible impact of privatization of BPCL on Indian economy, we compared the possible fiscal deficit in both the cases (if BPCL is privatized and if BPCL is not privatized).

For this comparison, we affirmed some assumptions below:

Assumption-1

In both the cases, GDP remains the same as stated in the Union Budget 2020-21.

Assumption-2

BPCL will distribute all its profit to its equity shareholders and retained profit would be zero.

Assumption-3

Tax receipts to the government from BPCL in both the cases would be same. (In an actual scenario tax rate for company is different under the private ownership and under the government ownership.)

Assumption-4

Interest rates would be same in both the cases. (In reality if disinvestment receipts decreases than borrowings of the government and interest rates on that borrowings increases.)

Assumption-5

Closing market price of the share on the last trading day of the FY 2019-20 is taken as the base of calculating privatization proceeds.

Assumption-6

Welfare expenses would be same in both the case. (In actual scenario, when any SOE is privatized and there is not any condition of retaining the employees even under the private ownership then many times it results in the layoff of the current workforce. The higher the number of the employee laid off, the higher the unemployment rate in the economy and the higher the welfare expenses for the unemployed workforce.) Estimated Fiscal deficit at the time of privatizing BPCL is directly borrowed from the Union Budget 2020-21. We calculated estimated fiscal deficit for the scenario if BPCL is not privatized by adding privatization proceeds and deducting dividend income.

Data Analysis Interpretation

In order to evaluate and compare future financial performance of BPCL in both the case (if it is privatized and if it is not privatized), we have used financial ratio analysis. The outcome of the result from the financial ratio analysis in both a cases is shown in the following Table.3.

Table:3, Estimation with Regression Model without Intercept

	If BPCL will not be privatized			If BPCL will be privatised		
Ratios	2019-20	2020-21	2021-22	2019-20	2020-21	2021-22
Net Profit Margin	3.22%	3.45%	3.68%	2.58%	2.63%	2.68%
Net Profit to Net Worth	26.48%	27.64%	28.77%	19.85%	19.49%	19.17%
Operating Profit to Long-term Capital Employed	25.36%	26.45%	27.52%	19.60%	19.43%	19.28%
Total Expenses to Total Income	95.76%	95.59%	95.43%	95.15%	94.89%	94.64%
Net Sales to Net Fixed Assets	537.92%	512.85%	490.52%	609.50%	597.39%	586.34%

Source: Author's Calculation

For making ratio comparison simple the below table (4) is presented. In this table (4) "1" represents better position while "0" bad position. Net Profit Margin and Net Profit to Net Worth favor the case of privatizing BPCL, and all the other ratios are favoring the case of not privatizing BPCL. The result shows the case of privatizing BPCL would bring improved efficiency while that of not privatizing BPCL would bring better profitability.

Table:4, Comparison of Financial Ratios of the Estimated Data from Regression Model without Intercept

	If BPCL will not be privatized				If BPCL will be privatized				
Ratios	2019 -20	2020-21	2021-22	Total	2019-20	2020-21	2021-22	Total	Total
Net Profit Margin	1	1	1	3	0	0	0	0	3
Net Profit to Net Worth	1	1	1	3	0	0	0	0	3
Operating Profit to Long-term Capital Employed	1	1	1	3	0	0	0	0	3
Total Expenses to Total Income	1	1	1	3	0	0	0	0	3
Net Sales to Net Fixed Assets	0	0	0	0	1	1	1	3	3
Total	4	4	4	12	1	1	1	3	15

Source: Author's Calculation

The Table (4) shows that 12 out of 15 parameters favor the case of not privatizing BPCL. More precisely, all the profitability ratios are in the favor of the case of not privatizing BPCL and the efficiency ratio gives neutral view for both the cases.

Table:5, Estimation with Regression Model with Intercept

	If BPCL will not be Privatized			If BPCL will be Privatized		
Ratios	2019-20	2020-21	2021-22	2019-20	2020-21	2021-22
Net Profit Margin	3.14%	3.32%	3.51%	8.53%	10.41%	12.51%
Net Profit to Net Worth	21.95%	21.32%	20.64%	22.33%	21.67%	20.96%

Operating Profit to Long-term Capital Employed	22.22%	22.08%	21.86%	15.66%	14.00%	12.52%
Total Expenses to Total Income	95.14%	94.80%	94.47%	88.17%	88.06%	88.03%
Net Sales to Net Fixed Assets	440.16%	387.20%	341.72%	194.64%	155.56%	125.74%

Source: Author's Calculation

Table (6) shows that 9 out of 15 parameters favor the case of not privatizing BPCL. All the efficiency ratios one out of three profitability ratios are in the favor of not privatizing BPCL. Estimation of the both the models gives the same results in the context of two ratios (i.e, Operating Profit to Long-term Capital Employed and Total Expenses to Total Income) but the other ratios are giving opposite conclusion in both the models. So, we can say that if the BPCL is not privatized, operating profit would be high and total expenses would be low. Though we can expect better profitability and better efficiency in the case of not privatizing BPCL as most of the ratios (21 out of 30) are favoring that case.

Many empirical studies in the past have proved that privatization improves the efficiency, however they have not given any concrete reason for improved efficiency after privatization. However T. Ram Mohan (2005) explores the reasons behind better performance after the privatization. According to him there are mainly three reasons for improving efficiency under the private ownership: Firstly, Lay off of the employees (Which results in reduced labor cost and increase in per employee revenue.) Secondly, Increase in product price while cost remaining unchanged (Which results in higher profit margin.) and thirdly more productivity due to higher efficiency. Most of the authors and governments always highlight the third reasons but the first two reasons are always kept hidden to argue in support of privatization.

When the government is not able to reduce unproductive expenditure or is not able to raise tax revenues it results into fiscal deficit. Generally, fiscal deficit is bridged by additional money supply by the central bank of the nation or by borrowing from the public. Additional money supply leads to inflation while borrowing leads to higher interest rates and crowing out of private investment as shown in IS-LM framework. Both the situation is not desirable for the economy. As coated in the press note released by PIB (the press information Bureau) on November 20, 2019, in which one of the objective of BPCL privatization is to unlock resources blocked in BPCL and utilize them in financing social sectors for the benefit of the public. But if we see in the past, most of the time government has utilized these proceeds not in developing physical, social and legal infrastructure but to meet fiscal pressure in the economy. If the privatization proceeds are used to bridge the fiscal deficit, it reduces pressure on government to cut expenditure or raise taxes. This merely defers the fiscal problem, it does not mitigate it.

Table 7; Estimated Fiscal Deficit if BPCL is not Privatized

Particulars	Amount (in Rs Crore)
Estimated Fiscal Deficit if BPCL is Privatized	7,96,337
Add: Disinvestment proceeds from BPCL	36,319
Less: Final Dividend	5,816
Estimated Fiscal Deficit if BPCL is not Privatized	8,26,880

Source: Author's Calculation

As per the Union Budget 2020-21, the estimated fiscal deficit is Rs 7,96,337 Crore (i.e. 3.5% of GDP). At the same time table (7) shows that the estimated fiscal deficit if BPCL is not Privatized then it is Rs 8,26,880 (i.e. 3.7%). In this case if BPCL is continued to be a CPSE than fiscal deficit of our economy would be higher by 0.2 percentage point of GDP which is Rs 44,979 Crore in absolute terms. But here, we should note that in calculation of fiscal deficit we have not considered the savings in welfare expenses for the workforce laid off because of the privatization, future bonus share offers, changes in the expenses of payment of interest, changes in tax revenue. We should also keep in mind that if we get that proceeds from privatization, then it would onetime event only; and in contrary to that if BPCL is not privatized then government will receive dividend every year. BPCL is giving final dividend to its equity share holders at the rate 105% of face value (weighted average) and interim dividend at the rate 165% of

Table:6, Comparison of Financial Ratios of the Estimated Data from Regression Model with Intercept

	If BPCL will not be Privatized				If BPCL will be Privatized				
Ratios	2019-20	2020-21	2021-22	Total	2019-20	2020-21	2021-22	Total	Total
Net Profit Margin	0	0	0	0	1	1	1	3	3
Net Profit to Net Worth	0	0	0	0	1	1	1	3	3
Operating Profit to Long-term Capital Employed	1	1	1	3	0	0	0	0	3
Total Expenses to Total Income	1	1	1	3	0	0	0	0	3
Net Sales to Net Fixed Assets	1	1	1	3	0	0	0	0	3
Total	3	3	3	9	2	2	2	6	15

Source: Author's Calculation

face value (weighted average) every year. So if we give the effect of future dividend for the next few years and other variables (savings in welfare expenses for the workforce laid off because of the privatization, future bonus share offers, changes in the expenses of payment of interest, changes in tax revenue) in the calculation of the fiscal deficit, then we can surly say that fiscal deficit would be less than 3.7% (even less than 3.5%).

Conclusion and Recommendation

With the help of theoretical concepts, empirical data, statistical tools and techniques, we analyzed the research problem in depth. With the outcomes we can conclude that BPCL is giving better profits and efficiency under the government ownership. The reason being out of 30 parameters we studied, BPCL out performs 21 under the state ownership. Although this contradicts the opinion of many who are in favor of privatization. But we see concrete reasons under the private ownership; i.e. it can either lay-off the work force or increase in the price of the output or better management or the combination of all. And Privatization of BPCL will help government reducing the fiscal deficit by approximately 0.2 percentage point. But the benefit is short term in nature. Economy can gain more from the dividend rather than disinvestment revenue in long run. In this way, it is more beneficial for our economy not to privatize BPCL. It is suggested that if government wants to unlock the resources blocked in the PSUs, it is better to privatize loss making PSUs as the contribution of profit making PSU would more in the Indian economy if it is not privatized.

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