Implications of LIC Disinvestment

What can we learn from China & Singapore?

INTRODUCTION

During the annual budget presentation in February 2021, Finance Minister Nirmala Sitharaman announced the proposed sale of a portion of the government’s “stake” in Life Insurance Corporation of India (LIC). This announcement caused anxiety amongst millions of policy holders considering they had covered their life & post retirement income risks with LIC products. In order to understand the rationale behind the proposal, one needs to acknowledge that LIC is unparalleled to anything out there in the world of finance.

Life Insurance Corporation (LIC) of India, the magnum opus of the PSUs, was formed by an act of Parliament in 1956. It is as predominant as the socialist mammoths like the State Bank of India (SBI) and the Steel Authority of India. Although LIC holds largest market share in Life Insurance, the company has been steadily losing share to private companies. Life Insurance Corporation share in first year life insurance premium declined from 74%(FY 06-07) to 69%(FY 19-20). In the FY 19-20, LIC has over 115,000 employees and assets of more than Rs 32 lakh crore which makes it larger than most companies’ asset size. The gigantic policyholder base of 290 million almost equals the population many countries combined. The reported gross total income of the company in the FY 2019-20 was Rs 6.16 lakh crore and achieved a net profit of Rs 2,713 crore.
ABOUT THE DISINVESTMENT

The listing size of LIC is likely to make it the largest-ever IPO in the history of domestic market. The estimated initial divestment target of about 10% of paid-up capital would be valued at Rs 2500 crores. With the expected premium, the IPO size is projected go up to Rs 1 lakh crore. As per market analysts, post IPO market capitalization of LIC is expected to be above 8 lakh crore, some estimates even go to 15 lakh crore. Offer size indicate a premium, and price is estimated to be in the range of Rs 400 to 600 per share.

Since LIC holds a special legal status, it also mandates some amendments in LIC Act to be passed in Parliament before the divestment could be initiated, including changes in corporate governance. Currently LIC has 100% government ownership. Basis amendments proposed in Finance Bill 2021, the government will not disinvest more than 25% stake in first 5 years and will never have shareholding below 51%.

The divestment is expected to be closed in current Fiscal.

STATED PURPOSE OF DISINVESTMENT IN LIC

The listing process regulates the company while allowing the financial markets to create value creation. The above ‘raison’ was stated for stake sale in LIC. Moreover, it is also an opportunity for the retail investors to create wealth.

Though LIC has seen some share decline in the life insurance market after Insurance sector opened up, it still holds considerable market share. Adding efficiencies through disinvestment presents an opportunity to strengthen the company’s market position and that makes an attractive investment opportunity for investors.

The disinvestment in LIC will provide wealth creation opportunity to investors, while helping the government manage fiscal deficit challenges.
The proposed disinvestment of the mammoth Life Insurance Company (LIC) will improve transparency and market accountability.

It is also predicted that the life insurance industry in India will see a surge in foreign capital inflows, enticing more foreign interest from the latest IPO.

The following gains can be expected from the LIC disinvestment:

**GAINS FOR THE INVESTOR**
- Change in corporate governance and mandatory listing disclosures are likely to bring more scrutiny to the LIC’s financial statements and adding to the transparency / accountability
- Possibility of higher dividend in line with market expectations

**GAINS FOR THE GOVERNMENT**
- Unlocking value of an asset. Privatization trends from past indicate the improved financial performance of the privatized entities including the net worth of the company. With improved net worth of LIC, government will be able to raise more money in the future.
- Easier to meet its disinvestment goals.
- Continuing returns from LIC, since government never intends to go below 51% ownership.

**GAINS FOR LIC**
- Disinvestment will lead in accelerating accountability & efficacy in LIC’s business.
- As India’s largest financial institution, it can emerge as one of the top companies with regards to market valuation.
- Disinvestment can usher in efficiency gains, and has been seen as historical trend for most government entities that have been disinvested.

**Similar Cases**

**The Chinese Model**

Since the 1950s, China’s evolution has been largely SOE-led. By the late ’80s, they measured 75% of China’s manufacturing production. By then, they had also become unproductive with many SOEs becoming bankrupt. Later in the 1990s and 2000s, a wave of SOE restructuring followed by the setup of SASAC (State-owned Assets Supervision and Administration Commission) in 2003 to administer SOEs.
The SOE reform in 90s adopted the policy of ‘grasping the large, letting go of the small’, as a consequence number of SOEs were reduced significantly. This was supported by ownership reform and eventually led to decline in SOEs contribution to gross output from 52% (1998) to 44% (2002). Studies indicate that the reforms helped in improving efficiency as well as the commercial performance of SOEs. Reports also suggest, that between 1998-2002 there was positive impact with Return on Assets & Return on Equity improved significantly and almost nearing the private sector performance; however, the bad debt remained a problem and also all SOEs did not perform well.

SASAC has turned out to be a sole destination for SOE management ranging from strategic choices to appointments. A surge was seen in their power in the first decade of 2000. In 2006, SOEs in some sectors were included in the strategic focus and included Defence, power generation and distribution, oil and petrochemicals, telecommunication, coal, civil aviation, & shipping with 100% government control and ownership.

After 2003, for SOEs, the expansion to global markets was an important objective that was achieved through public listing and cross border M&As. Evidently, China’s share in Fortune 500 has grown considerably from 10 in 2001 and is nearing the US in terms of number of companies in global list of Fortune 500. In 2020, there were 91 Chinese SOEs in Fortune 500 from Mainland China and 26 other Chinese companies, while there were 121 US based companies in the list.

It’s difficult to say with certainty the share of SOEs in China’s GDP, however Asian Development Bank in their report published in 2020 on SOEs, estimated it to be at 30%; while Worldbank estimated SOE’s share in GDP to be in range of 25-30% in their analysis published in 2019. Looking at the impact SOEs have, government see it as important vehicle to push their objectives.

Recently, in 2020, Chinese government initiated a reform process that was approved by Central Commission for Comprehensive Reforms to “optimise and restructure the state economy layout” through “stronger, better and bigger” SOEs. The rationale behind the move is SOE’s massive contribution on the country’s road to recovery from COVID crisis, wherein SOEs played a critical role. In 2020 the reforms were initiated that included bringing in private investors as stakeholders of the SOEs to further enhance the operational efficiencies and improve the governance.

Overall China’s embrace of SOE privatization has been strategic and at a slower pace, while maintaining government control. The process has delivered efficiencies & growth for the SOEs. In 2020, China’s 97 central SOEs generated net profit of $215.77 billion amid decline in revenue because of COVID Pandemic. However, all SOEs have not exhibited spectacular gains as there are multiple factors at play. Local SOEs with not so efficient governance are not performing as the government would like them to be.
The Temasek Model

Singapore vigorously pursued economic growth post its independence by taking stakes in many companies, including start-ups. To improve management of assets and better commercialization, Temasek Holdings was incorporated in 1974. Though owned by the government, the holding company is run by professionals with aim of maximizing shareholder value. The model is considered to be very successful, that has delivered the strong results.

Temasek’s initial portfolio was S$354 million, spanning 35 companies, which were then taken into account for the process of restructuring SOEs. The restructuring process involved corporatization, privatization and global expansions.

Corporatization took place in companies like SingTel, PSA, Singapore Power and MediaCorp. Many aged SOEs have scaled up to a point of being big global brands like Singapore Airlines, SingTel, Singapore Zoo, DBS and Keppel. Temasek’s role has seen a revolution.

The model has delivered spectacular results, portfolio value of Temasek has risen to S$306 billion in 2020 from S$354 million in 1974. It has been actively investing while also divesting over the past decade. As reported in 2020, since 1974, Temasek delivered 14% compounded annualized total shareholder return.

Conclusion

Government of India has taken a daring step by putting forward the plan of disinvestment of LIC via public listing in the budget 2021. The news created disappointment amongst the employees and some sections of the public and various strikes have been organized by them as a sign of rejection of proposal. Despite such protests, the government remains optimistic. Like two sides of a coin, the disinvestment has its pros and cons.

Looking at historical evidence of SOEs in China and Temasek in Singapore, there is potential to generate efficiencies, strive for global leadership and deliver strong total shareholder return for the investors.
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