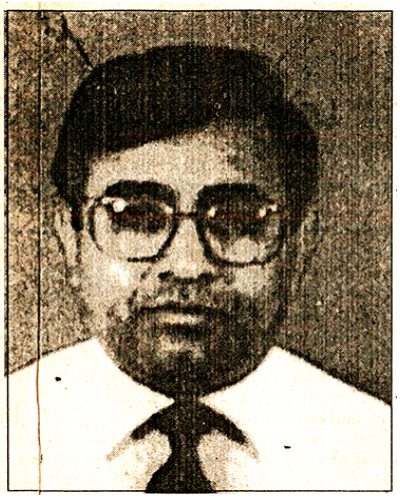
GIVING AWAY THE FAMILY SILVER

"Would it not be correct to say that the Korean company, Hanjung, got the steel mill as a free gift?"

LEFT: President Chandrika Kumaratunga — Should not the finance minister take responsibility for selling 'the family silver''?

RIGHT: Chairman PERC, Dr. P. B. Jayasundera — Novel calculation of purchase price



The Sunday Leader today turns the spotlight onto the process of privatisation of public corporations. Privatisation of a public utility or a socio-economically important monopoly, could not thereby abdicate a government's responsibility to the consumer public, without ensuring adequate safeguards to protect the interests of the consumer public. Very basic privatisation strategies and methods developed globally have successfully addressed these real and important issues.

Privatisation involves, not only the sale of public assets, which is public property, but also the ensuring of the continuity of the supply of the goods and services by such public corporations, at fair and competitive prices to the public, at the requisite qualities, preventing any unfair exploitation of the consumer public, through monopolistic tendencies; ensuring also the achievement of socio-economic objectives of the development of a free and open economy, with desired levels of growth, productivity and employment.

This naturally calls for the transparency, not merely of the commercial transaction of sale, but also of the rationale of the strategies involved, to ensure the protection of the interests of the public - after all, it is their means of production of goods and/or the provisioning of services that are being disposed of. There is an inherent commitment and responsibility on the part of the government, to ensure the protection of the interest of the public.

The process of privatisation is also to achieve the socio-political objective of a share owning public, with the broad basing of corporate ownership, thus developing a healthy and vibrant capital market. The listing of a privatised enterprise in the stock exchange brings such enterprise under the regulatory framework of public accountability and, the transparent scrutiny of market oriented performance evaluation in the face of market expectations.

Given this scenario, *The Sunday Leader* probes the recent privatisation of the Ceylon Steel Corporation Ltd.

CHIEF GOVERNMENT VALUER

On 16th March 1994, the Chief Government Valuer issued his Valuation Report as at 1st December 1993 of Ceylon Steel Corporation Ltd., which, Valuation Report, inter-alia, stated as follows;

> " Since the inception, the factory has been operating below capacity. However, the rolling mill has been operating in or around 60% capacity in the recent years, while the wire mill and the steel foundry has been operating below 40%. The melt shop which has an annual capacity of 65,000 tonnes, has not been put into commercial operations at any time, and at present the plant is idling while the company has to maintain it at a substantial cost in order to conserve it. Hence it appears that the melt shop is economically not viable.
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> The tentative valuation of the fixed assets of the enterprise indicates a figure of Rs.1,053 Mn. In arriving at this value only a nominal value has been attributed to the buildings and plant & machinery coming within the Stage 11 of the enterprise.
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> The above valuation when appropriately adjusted for current assets and current liabilities and long term liabilities indicates a net asset value of Rs. 1,501 Mn.
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> The tentative valuation on the basis of the trading potential indicates a net present value of Rs. 1,080 Mn. Once appropriately adjusted for non performing assets, current assets and liabilities etc., this indicates a value of Rs.1,322 Mn. Considering all aspects of the investment market and the physical condition of the fixed assets, the profitability of the enterprise, and in view of the fact that the enterprise is put into the market as one entity (Lock, Stock and Barrel), Rupees One thousand four hundred million (Rs. 1,400. Mn.) is recommended as the floor price in the event of transfer of ownership of the enterprise."

THEN GOVERNMENT'S STRATEGY

On 2nd March 1994, the Evaluation Committee reported on six offers that had been received for the sale of 55% of the Shareholding of Ceylon Steel Corporation Ltd. The Evaluation Committee recommended the highest offer from a Consortium comprising of the Development Finance Corporation of Ceylon Ltd. [DFCC], S.N.K. International Co. Ltd. of Japan and Godo Steel Ltd. of Japan, who had bid a firm price of Rs. 962.5 Mn. for 55% of the Shareholding of Ceylon Steel Corporation Ltd. Comparatively, the Floor Price recommended by the Chief Government Valuer for this 55% Shareholding was Rs. 770 Mn.

Given the credentials of the DFCC, the leader of the Consortium, it would stand to reason, that there was no doubt on the financial capability and the technical competence of the Consortium, that too from Japan, a financially and technically well advanced country.

On 20th April 1994, the Cabinet approved the sale of 55% Shareholding of Ceylon Steel Corporation Ltd. to the Japanese Consortium led by DFCC in accordance with the following strategy:

> 55% Shares to be sold to the Japanese Consortium led by DFCC.
> 25% Shares to be issued to the public.
> 10% Shares to be gifted to the employees.
> 10% Shares to be retained by the Government, with the right of the Government to have a nominee on the Board of Directors of the privatised company.

The rationale of a public Share issue, is not only to broadbase the share. ownership and develop the nascent capital market, but also to subject the management of the privatised enterprise to the regulatory framework of public accountability, that a listed public company is subjected to, and to the transparent scrutiny of competitive market oriented performance evaluation, in the face of market expectations.
The then government's commitment to have a continued 10% interest, with a right of representation on the Board of Directors of the privatised enterprise, very clearly underscores the socio-economic importance of this steel industry, which is a base industry, and the need to safeguard the interest of the public in the supply of such a basic product, which is an important and essential input for the growth of the construction industry.

PERC CHANGES COURSE

The present government was assisted by the Public Enterprise Reform Commission [PERC], who called for fresh bids to dispose of 90% of the Shareholdings of Ceylon Steel Corporation Ltd. Obviously to Members of PERC, some of the abovementioned considerations and pertinent strategies that had to be addressed in carrying out privatisation were of no concern, whatsoever, clearly being oblivious thereof. Mr. Rajan Asirwatham, Senior Partner of Ford, Rhodes, Thornton & Co. Chartered Accountants was the Chairman of PERC, when Ceylon Steel Corporation Ltd. was privatised.

The classic example of the privatisation of the Colombo Gas Company that has led to a monopolistic fiasco, affecting the interests of the consumer public, causing a public furore, was simply because the very basic and elementary principles and strategies of privatisation of a public utility had not been adhered to. How and why? Should not the entirety of PERC have been called upon to immediately resign? Why should the public have to pay, for the learning process of amateurish inexperience?

On 31st October 1996 Brandigampolage Chandradasa Perera, as the Secretary to the Treasury, acting for and on behalf of the Government of Sri Lanka [GOSL], entered into a Share Sale and Purchase Agreement with Korea Heavy Industries & Construction Co. Ltd. (Hanjung), a Korean Company for the sale of 90% of the shareholdings of Ceylon Steel Corporation Ltd. The said Sale and Purchase Agreement, inter-alia, stipulated:

> " Sale and Purchase of Shares; Purchaser agrees to purchase from the Vendor and the Vendor agrees to sell and transfer to Purchaser, Ninety Million (90,000,000) Shares (hereinafter referred to as "Applicable Shares") for an aggregate consideration equal to United States Dollars Fifteen Million only

(US $ 15,000,000) being the Purchase Price payable in accordance with the provisions of Clause 2.3, provided that if there is a diminution of the value of the net assets of the Company from that disclosed in the Company Profile dated September 1995 and the Management Accounts of the Company as at 30th June 1996, the parties agree to negotiate in good faith, a reduction in the Purchase Price to reflect such diminution of the value of such net assets provided that such claim shall not exceed 10% of the Purchase price and is made within 60 days of the Closing Date.

The Purchaser agrees to commence modernization of the Company immediately after the Closing Date. For this purpose, the Purchaser agrees to deposit immediately an additional amount of US $ 10 million in an escrow account in the name of the Company, or in the alterative, provide within fourteen (14) days of the Closing Date, a bank guarantees(s) for US $ 10 million payable to the GOSL, issued by the Korea Exchange Bank, which binds it to pay a sum of US $ 10 million on demand after a period of six (06) months from the Closing Date. Where the GOSL has drawn on such guarantee(s) by reason of the failure of the purchaser to advance such sums to the Company then the GOSL shall deposit the money so paid in an escrow account in the name of the Company to enable the Company to utilise the same for its modernization."

FINANCIAL DATA

As per the Profile of Ceylon Steel Corporation Ltd., prepared in September 1995 by Ernst & Young, Chartered Accountants, and data subsequently made available by PERC, the Balance Sheets of Ceylon Steel Corporation Ltd. has been given as follows:

	31.12.93 Rs.Mn.	31.12.94 Rs.Mn.	31.12.95 Rs.Mn.	30.06.96 Rs.Mn.
Fixed Assets at Written Down Value	452	420	381	363
Current Assets				
Stocks	375	463	535	504
Debtors	65	79	112	95
Prepayments	19	180	50	232
Fixed Deposits	100	200	300	300
Cash at Bank	110	(107)	(38)	(190)
	669	815	959	941
Current Liabilities				
Creditors	126	126	117	39
Gratuities	50	55	58	58
	176	181	175	97
Net Current Assets	493	634	784	844
Net Assets	945	1054	1165	1207
Share Capital	350	350	1000	1000

Revaluation Reserve	111	111	-	-
Reserves	484	593	165	207
	945	1054	1165	1207

The Ernst & Young Profile has given the Turnover & Profit before extra-ordinary items and tax of Ceylon Steel Corporation Ltd. as follows:

	Turnover Rs.Mn.	Profit Rs.Mn.
1991	1195	131
1992	1243	127
1993	1291	159
1994	1590	200
1995(6 months)	825	90

The Ernst & Young Profile has also given the summary of the Fixed Assets of Ceylon Steel Corporation Ltd., as follows:

	Cost/re-valuation Rs.Mn.	Depre-ciation Rs.Mn.	Written Down Value Rs.Mn.
Land at Athurugiriya, Colombo District-183 Acres	79	-	79
Buildings	164	35	129
Plant & Machinery	458	263	195
Motor Vehicles	19	9	10
Furniture & Fittings	2	1	1
Office Equipment	7	1	6
	729	309	420

VALUATION NEEDED UPDATING

The Fixed Assets Valuation given by the Chief Government Valuer as at 1st December 1993 has been Rs. 1,053 Mn. and adjusted for current assets and liabilities as at that date, this had given an assets valuation of Rs. 1,501 Mn. as at 1st December 1993. In considering the assets valuation of Rs. 1,501 Mn. and the net present value of the trading potential of Rs. 1,322 Mn., the Chief Government Valuer fixed the floor price of Rs. 1,400 Mn. for the entire shareholding of Ceylon Steel Corporation Ltd. as at 1st December 1993.

The net current assets thereafter as at 30th June 1996 has increased to Rs. 844 Mn., i.e. by Rs. 351 Mn. The fixed assets valuation of Rs. 1,053 Mn. as at 1st December 1993 would also need adjustment for current rupee value to 30th June 1996. This would result in the floor price being reckoned to move from the value given by the Chief Government Valuer as at 1st December 1993, appreciably to a level between Rs. 1,800 - Rs. 1,900 Mn. as at 30th June 1996. It would be noted that the Ceylon Steel Corporation Ltd. had Fixed

Deposits of Rs. 300 Mn. as at 30th June 1996. The Overdraft of Rs. 190 Mn. had only financed a pre-payment of Rs. 216 Mn. for clearing a shipment of materials.

Whilst in 1994, on a floor price of Rs. 1,400 Mn. for the entire shareholding, a 55% Shareholding was to have been sold for Rs. 962.5 Mn. In contrast in 1996, a 90% Shareholding has been sold for US $ 15 Mn., which is only SL Rs. 840 Mn. The floor price valuation for this 90% shareholding as at 30th June 1996 could be reckoned to be around Rs. 1600 Mn. to 1700 Mn. based upon the Chief Government Valuer's valuation as at 1st December 1993, and could be reckoned to be around Rs. 1850 Mn., based upon the firm price agreed upon in 1994 for the purchase of 55% shareholding, in the context of the subsequent appreciable increase in the levels of net current assets.

DR.P.B.JAYASUNDERA'S BUFFOONERY? / RAJAN ASIRWATHAM'S FREE GIFT?

In defending this Sale at such price, at the recent Press Conference had at the Presidential Secretariat, chaired by Her Excellency the President, in response to a question, by the well known and reputed journalist, Waruna Karunatilake, the Chairman of PERC, Dr. P.B. Jayasundera, when called upon to answer, blatantly spouted, that the purchase consideration was not only US $ 15 Mn., but one had to also take into reckoning the US $ 10 Mn. that the purchaser, the Korean Company, had agreed to invest in the Ceylon Steel Corporation Ltd. and that thereby the total to be reckoned would be US $ 25 Mn. What intellectual buffoonery or tomfoolery is this crap? - That too coming from a Doctor of Economics at that! Would Dr. P.B. Jayasundera, if he has a house, sell his own house worth Rs. 18 Mn. for Rs. 8 Mn., because the prospective buyer agrees to modernise it thereafter spending Rs. 5 Mn.?

The Net Current Assets of Ceylon Steel Corporation Ltd. as at 30th June 1996 has been Rs. 844 Mn., with Stocks of Rs. 504 Mn. and Bank Deposits of Rs. 300 Mn., Creditors being only Rs. 39 Mn. and the only other liability being Gratuities, which is not immediately payable of Rs. 58 Mn. For a purchase consideration of only Rs. 840 Mn. [US $ 15 Mn.] the Korean Company, Hanjung, got liquid net current assets amounting to Rs 844 Mn. Therefore, would it not be correct and logical to postulate, that the Korean Company, Hanjung, got the Steel Mill i.e. the Land, Buildings, Plant, Machinery, etc., as an absolutely free gift? If not, how much have they paid for it? How would the then Chairman PERC, Rajan Asirwatham, being a Chartered Accountant, a Partner of Ford, Rhodes, Thornton & Co., account for this to the public, whose asset in fact had been so alienated?

PROTECTIONS TO BUYER

After buying 90% of the Shareholdings of Ceylon Steel Corporation Ltd. for Rs. 840 Mn., the Korean Company virtually owns it. What they would spend thereafter on it, is what they would be spending on themselves! How this ever came to be propounded as part of the purchase consideration by a Doctor of Economics at that, is beyond all imagination! On the balance 10% Shareholdings, the Share Sale and Purchase Agreement speaks as follows:

" Additional Share Divestiture: The Parties acknowledge that the Vendor intends to, but is not required to, distribute the remaining 10% of the Shares to employees of the Company, on or as soon as practicable after the Closing Date."

The Sale and Purchase Agreement apparently has not provided for the regulation of a pricing mechanism, which would essentially be a requisite, since a virtually captive domestic market, sensitive to the growth of the construction industry, is enjoyed by the privatised enterprise. Though the domestic consumer is the only buyer of the products, no public share issue has been provided for, for the local public to participate in a broadbased share ownership, that would be characteristic of a free and open economy.

Whilst there is no safeguard or protection on a pricing mechanism, particularly in the absence of cognisable competition, on the contrary, the Share Sale and Purchase Agreement has provided:

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"That the Company will operate under lower tariff levels on imported steel products into Sri Lanka over the medium term."

TRANSPARENCY AND CONFIDENTIALITY ?

As for much pontificated transparency, this is what the Share Sale and Purchase Agreement has stipulated :

" Purchaser Bound by Confidentiality Undertaking: Purchaser agrees that it shall continue to be bound by the provisions of the Confidentiality Undertaking of 23rd July 1996 between the Parties, provided however that this provision shall be without prejudice to any rights of the Purchaser under this Agreement."

Interestingly, the Ernst & Young Profile discloses that the Department of Inland Revenue had raised income tax assessments amounting to Rs. 96.7 Mn. on Ceylon Steel Corporation Ltd., under Section 39 of the Inland Revenue Act on the basis of profits deemed as distributed, whereas there had been no actual distribution of any such profits. On the other hand, in the case of Puttalam Cement Co. Ltd. a revaluation reserve had been created, revaluing the fixed assets, and money had been appropriated by the majority non-resident shareholders of the company for their own benefit. Section 40 of the Inland Revenue Act specifies such appropriations as taxable profits in the hands of those, who made such appropriations, whilst the company's taxable profits being reduced thereby; this would affect the interests of the employee shareholders.

WORSE THAN NYLON 6 ?

A poignant comparison comes into focus - the privatisation of the Nylon 6 Plant. This in comparison was running at a loss and sold at a price below the valuation given by the Chief Government Valuer, but above the net present value determined by Ernst & Young, Chartered Accountants, of a projected discounted cash flow; in comparison with no captive domestic market for the output. The Special Presidential Commission has found the then Minister of Power & Energy, late Chandra Bandara and then Secretary of the Ministry, Akiel Mohamed guilty of misuse and abuse of power, causing loss thereby to the government.

On the other hand, Ceylon Steel Corporation Ltd. had been running continuously at considerable profits, with a captive domestic market. What would the findings of the Special Presidential Commission be, if the privatisation of the Ceylon Steel Corporation Ltd., is warranted to be inquired into? Would not equitable social justice demand such inquiry? Would not the Indian judiciary have caused such inquiry and held those responsible accountable, through the process of public interest litigation? Should not such process of public interest litigation be pursued in instances such as this?

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