***Privatizing a Profit-making National Oil Company in India: Exploring the Rationale and the Challenges***

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## Overview

India has followed a unique path among the developing countries by maintaining fragmented national oil companies (NOC) that have a dominant share in every segment of the domestic oil and gas industry. The Indian government’s announcement in 2019 to completely privatize Bharat Petroleum Corporation Limited (BPCL), the second-largest Indian downstream NOC, has led to a public debate on the rationale behind privatizing a profit-making NOC. The proponents argue that BPCL privatization will bring an increase in its operational efficiency and competition in the marketing segment of the oil industry. The opponents argue that privatization will only fulfill the government’s fiscal target in the short term, and the government’s intended goals of improved efficiencies and competition will not be realized. [Wolf (2009)](#_ENREF_1), in a quantitative study, concluded that NOCs perform poorly to private oil companies, and partial or complete privatization of NOCs could improve their performance. In the last ten years, partial privatization of NOC has occurred, but none of the NOCs in 64 countries have been completely privatized. The Indian government had previously failed at privatizing BPCL in the year 2002. Thus the Indian government’s intention to completely privatize BPCL will be a significant break from its 30-year-old history of restructuring the Indian oil and gas industry through partial price reforms, lowering import tariffs, mergers among NOCs, and partial privatization. Through our historical case study of 30 years, we analyze the rationale for privatizing a profit-making national oil company.

## Methods

We follow the case study method of analyzing the Indian government’s effort in restructuring the Indian oil and gas industry for the past 30 years. We make use of the policy statements and decisions taken by various governments, the recommendation of various expert committee reports that inform government’s decision, statistical publication of the Ministry of Petroleum and Natural Gas, Annual Report of Companies and academic studies as source materials to identify the difference between the stated intent and the impact of government policy on the Indian oil and gas industry.

## Results

After the abolition of the administered pricing mechanism and entry of private players in the marketing segment in 2002, the market shares of the three NOCs have only dropped from 81% to 76% in 2017. The market shares of Hindustan Petroleum Corporation Limited (HPCL) and BPCL — the second and third-largest player — have remained virtually constant in the marketing segment. BPCL and HPCL are the closest competitors to the largest player Indian Oil Corporation Limited (IOCL), but the variation in market share of IOCL is due to the domestic private companies like Reliance Industries Limited (RIL), Essar, Shell, BP and import competition. NOCs have collectively established high entry barriers by adding network infrastructure collusively. The size distribution of NOCs is highly asymmetrical and create a single firm dominance of IOCL. The government holdings in NOCs have decreased from around 75% in 2001-02 to around 57% in 2018-19. However, the government, through its financial institution, Life Insurance Corporation of India (LIC) and cross-holdings between NOC ensures that it still held around 70% of the shareholdings in the NOCs in 2018-19. Price deregulation of Petrol and Diesel since 2010 and 2014, respectively, and direct benefit transfer of LPG subsidies to households ensures that the historical burden of administering subsidies will not increasingly fall upon the NOCs. The employment in BPCL has been declining for the past decade, and the acquiring company will have limited scope to increase the performance of BPCL by retrenching employees and thus avoid a major cause of discord after privatization. The privatization of BPCL will only impact the dividend income received by the government while the rest of the taxes and duties will continue to be paid by the privatized BPCL. The government’s expectation of receiving privatization proceeds of 55000 Rs. Crore to 70000 Rs. Crore is an appropriate range considering the HPCL- ONGC, and Essar- Rosneft deals in the year 2017 and 2018, respectively. Thus, the privatization of BPCL will be net benefit by increasing competition and efficiency in the marketing segment of the Indian oil and gas industry.

## Conclusions

The competition in the marketing segment of the Indian oil and gas industry has not increased substantially despite the abolition of the administered pricing mechanism and the entry of private players in 2002. The structural links among NOCs through government holdings, holdings among NOCs, and LIC minority holdings in NOCs and private companies ensure that multiple NOCs operate as a single-entity and jointly dominate the marketing segment. The joint dominance of NOCs is strengthened by the market share stability exhibited by BPCL and HPCL - the second and third largest players in the marketing segment – in the last 20 years. The market share stability ensures that IOCL continues to be the dominant player in the marketing segment. The private companies, due to their infrastructure disadvantage and pricing policies of the government, are unable to challenge the joint dominance of the three NOCs. The completion of pricing reforms beginning with the deregulation of petrol and diesel prices and direct benefit transfer of LPG subsidies ensures that the entry barrier of government involvement in petroleum product pricing has been dismantled. The marketing segment of the oil and gas industry needs an effective competitor to the dominant firm IOCL and the financially integrated ONGC-HPCL. The privatized BPCL will not suffer the infrastructural disadvantage of a new firm and the shackles of public sector governance and obligations. BPCL has consistently delivered a better operational and financial performance as compared to IOCL and HPCLand its two coastal refineries – Mumbai and Kochi - can be leveraged by the private company for product exports and thereby earn valuable foreign exchange that can partially offset the burgeoning costs of crude oil imports. Thus, the privatized BPCL has the potential to induce much-needed competition and value addition in the marketing segment.

There are specific challenges that the government will bear during BPCL privatization in the short and medium-term. In the short term, the government has to ensure that it receives the appropriate amount by selling its stake in BPCL. The government needs to be vigilant that the privatization of BPCL is done with the right intention to introduce competition in the sector and not fulfill the fiscal target. The ONGC-HPCL deal is an example of how the government intention and reality diverged. The sale of the government’s stake in HPCL to ONGC only helped the government in fulfilling its fiscal target for that particular year, but it did not create an operational vertically integrated NOC till today. In the medium term, the main challenge that the government will face after BPCL privatization is fulfilling the social obligation void created in Kerosene and LPG distribution. BPCL supplies approximately 20% of the Kerosene and LPG needs of the country. The privatized entity cannot be forced to fulfill the social obligation of BPCL, and hence IOCL and HPCL will have to fill the void of BPCL. The government has not yet specified its plan to fill the BPCL social obligation void. We conclude that regardless of the rationale behind privatizing BPCL, the change in ownership will increase competition in the marketing segment with immediate effect. How the government plans to fulfill the social obligation void created after the BPCL departure will reveal the real costs of privatization.

## References

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