Asset monetisation — execution is the key

The Government's plan needs an Asset Monetisation Monitoring Authority to evaluate the execution

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The Government has announced an ambitious programme of asset monetisation. It hopes to earn ₹6 trillion in revenues over a four-year period. At a time when the Government's finances are in bad shape, that is money the Government can certainly use. Getting asset monetisation right is quite a challenge, though.

In asset monetisation, the Government parts with its assets – such as roads, coal mines – for a specified period of time in exchange for a lump sum payment. At the end of the period, the assets return to the Government. Unlike in privatisation, no sale of government assets is involved.

By monetising assets it has already built, the Government can earn revenues to build more infrastructure. Asset monetisation will happen mainly in three sectors: roads, railways and power. Other assets to be monetised include: airports, ports, telecom, stadiums and power transmission.

First, under-utilised assets

Two important statements have been made about the asset monetisation programme. One, the focus will be on under-utilised assets. Two, monetisation will happen through public-private partnerships (PPP) and Investment Trusts. Let us examine each of these in turn.

Suppose a port or airport or stadium or even an empty piece of land is not being used adequately because it has not been properly developed or marketed well enough. A private party may judge that it can put the assets to better use. It will pay the Government a price equal to the present value of cash flows at the current level of utilisation.

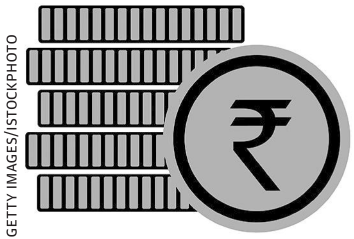
By making the necessary investment, the private player can reap the benefits of a higher level of cash flows. The difference in cash flows under Government and those under private management is a measure of the improvement in efficiency of the assets. This is a win-win situation for the Government and the private player. The Government gets a 'fair' value for its assets. The private player gets its return on investment. The economy benefits from an increase in efficiency. Monetising under-utilised assets thus has much to commend it.

Those well utilised

Matters could be very different in monetisation of an asset that is being properly utilised, say, a highway that has good traffic. In this case, the private player has little incentive to invest and improve efficiency. It simply needs to operate the assets as they are.

The private player may value the cash flows assuming a normal rate of growth of traffic. It will pay the Government a price that is the present value of cash flows minus its own return. The Government earns badly needed revenues but these could be less than what it might earn if it continued to operate the assets itself. There is no improvement in efficiency.

Suppose the private player does plan to improve efficiency in a well-utilised asset by making the necessary investment and reducing operating costs. The reduction in operating costs need not translate into a higher price for the asset than under government ownership. The cost of capital for a private player is higher than for a public authority. A public authority needs less equity capital and can access debt more cheaply than a private player. The higher cost of capital for the private player could offset the benefit of any reduction in operating costs.



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As we have seen, the benefits to the economy are likely to be greater where under-utilised assets are monetised. However, private players will prefer well-utilised assets to assets that are under-utilised. That is because, in the former, cash flows and returns are more certain. Private incentives in asset monetisation may not accord with the public interest.

Valuation and issues

There are other complications. It is very difficult to get the valuation right over a long-term horizon, say, 30 years. Does anybody know what would be the growth rate of the economy over such a period? For a road or highway, growth in traffic would also depend on factors other than the growth of the economy, such as the level of economic activity in the area, the prices of fuel and vehicles, alternative modes of transport and their relative prices, etc. If the rate of growth of traffic turns out to be higher than assessed by the Government in valuing the asset, the private operator will reap windfall gains.

Alternatively, if the winning bidder pays what turns out to be a steep price for the asset, it will raise the toll price steeply. The consumer ends up bearing the cost. If transporters have to pay more, the economy suffers. There is also the possibility that roads whose usage is currently free are put up for monetisation. Again, the consumer and the economy bear the cost. It could be argued that a competitive auction process will address these issues and fetch the Government the right price while yielding efficiency gains. But that assumes, among other things, that there will be a large number of bidders for the many assets that will be monetised.

Lastly, there is no incentive for the private player to invest in the asset towards the end of the tenure of monetisation. The life of the asset, when it is returned to the Government, may not be long. In that event, asset monetisation virtually amounts to sale. Monetisation through the PPP route is thus fraught with problems.

Another way of going about it

The other form of monetisation the Government has indicated is creating Infrastructure Investment Trusts (InvIT) to which monetisable assets will be transferred. InvITs are mutual fund-like vehicles in which investors can subscribe to units that give dividends. The sponsor of the Trust is required to hold a minimum prescribed proportion of the total units issued. InvITs offer a portfolio of assets, so investors get the benefit of diversification.

Assets can be transferred at the construction stage or after they have started earning revenues. In the InvIT route to monetisation, the public authority continues to own the rights to a significant portion of the cash flows and to operate the assets. So, the issues that arise with transfer of assets to a private party – such as incorrect valuation or an increase in price to the consumer – are less of a problem.

The pathway

What conclusions can we draw from the above? First, a public authority has inherent advantages on the funding side. In general, the economy is best served when public authorities develop infrastructure and monetise these. Second, monetisation through InvITs is likely to prove less of a problem than the PPP route. Third, we are better off monetising under-utilised assets than assets that are well utilised. Fourth, to ensure proper execution, there is a case for independent monitoring of the process. The Government may set up an Asset Monetisation Monitoring Authority staffed by competent professionals. The authority must put all aspects of monetisation under the scanner – valuation, the impact on price charged to the consumer, monetisation of under-utilised versus well-utilised assets, the experience across different sectors, etc. – and document the lessons learnt.

Asset monetisation is fine if executed properly – and that is always a big 'if'.

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