Stakes and mistakes

India's government is privatising companies for the wrong reasons.

Which flavour of condom do you prefer? Strawberry, chocolate or banana, perhaps? Prostitutes in India opted for paan, or betel nut wrapped in a leaf, which many Indians chew as a digestive. Their answer persuaded HLL Lifecare, a company based in the state of Kerala, to market a paan-flavoured condom. The sheath takes its place alongside the company's other offerings, including a textured condom and one that glows in the dark.

HLL Lifecare, which until this year was called Hindustan Latex, is one of 246 enterprises owned by India's central government. Spanning everything from nuclear energy to artificial limbs, these companies employed almost 1.6m people in 2008 and accounted for 8.3% of the country's GDP. On November 5th the government expressed a new willingness to reduce its stake in these enterprises. It wants the profitable ones to offer at least 10% of their shares to the public.

More than 40 public enterprises are already listed on India's stockmarkets, although the government still holds many tight to its chest. It clings to a 99.3% holding in MMTC, a listed company that trades minerals, gold, fertiliser and asbestos, among other things. If the government were to reduce its stake to 90% in all of its profitable listed companies, it would have to offer shares worth 278 billion rupees ($6 billion) at current prices. According to the government's new thinking, unlisted companies like HLL Lifecare, which have made profits for the past three years or more, could also offer shares to the public for the first time.

The Indian government has flirted with privatisation since 1991. Between 1999 and 2004 it even sold control of some companies, flogging a food company to Hindustan Lever and a telecoms company to the Tata family, for example. But the Congress-led coalition that took power in 2004 and won re-election this year has shown no great enthusiasm for privatisation. Its announcement this month is motivated more by worry than ambition. The government is facing a fiscal deficit of almost 7% this year. Selling stakes in profitable enterprises is a convenient way to raise money.

A better reason to privatise a company is to invite others to run it more efficiently. The number of lossmaking government enterprises has fallen over this decade, from 110 in 2001 to 53 in 2008. But the scale of the losses has crept up again in recent years (see chart). Air India lost $1.2 billion in the year to March 2009, prompting the government to propose an expensive bail-out. As the number of state-owned companies has held steady, countless private outfits have grown up, encroaching on their turf and liberating their customers. Travellers put off by Air India can fly with Jet Airways, India's biggest private airline, or Kingfisher instead.

Listing even a small stake helps keep managers on their toes, by subjecting them to the scrutiny of the stockmarket. But the bigger the float, the better. A drop in the government's shareholding from 100% to 50% raises the return on assets by about 24%, according to a recent study by Saibal Ghosh of the Reserve Bank of India, the country's central bank.

The rebranded Hindustan Latex shows how public enterprises can evolve, if given the freedom to do so. It began making condoms in 1969 to help the government curb India's rising population. Its early products prized function over form. Now it sells over 15 varieties under its Moods brand alone. The firm makes money, but also works with non-profits, such as Family Health International, to introduce products like the Velvet female condom. Its concern for customer choice resembles that of a private company. But its choice of customers, including India's prostitutes, still marks it out as a public concern.

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