



# Just size doesn't make PSUs good to invest in

BY HOWINDIALIVES.COM

**L**ife Insurance Corp. of India (LIC), if it does list on stock exchanges, would be among the last of government-owned businesses to offer shares to the public when they were still monoliths in their respective sectors. Before LIC, there was State Bank of India in banking, the troika of IOC, HPCL, and BPCL in oil refining, Coal India in coal mining, and GAIL in natural gas distribution, among others. Constructs of a time when the government played the lead role in business, these public sector undertakings (PSUs) had size and share. However, data shows that size alone does not ensure worthy returns for shareholders.

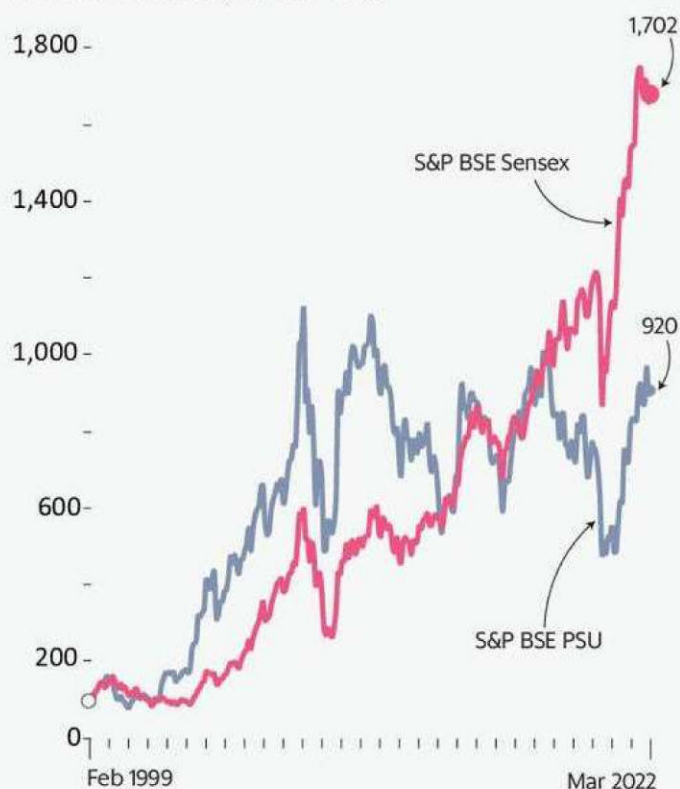
A measure of their performance is the S&P BSE PSU, an index of 30 companies owned by the government. Data for this index goes back 23 years to 1999. This shows three distinct patterns. One, the index outperformed the broader markets till about June 2013. Then, it moved in tandem till March 2018, before turning into a laggard.

Even if one scopes in on PSUs with significant share, less than one-fourth have outperformed the bellwether S&P BSE Sensex in the past 10 years. These include Container Corporation of India, Power Grid Corp. , and Nalco. Some, such as National Fertilizers, BHEL, and New India Assurance, have also delivered negative returns over this period.

These are cautionary stories for investors eyeing LIC as a stock. Much as LIC dazzles with its scale and sweep, its ability to deliver shareholder returns will be a function of additional factors, including valuation, growth, profitability, how it weathers private competition and how it deals with government interference.

## PSU stocks have seen two distinct periods of performance in the last two decades

Index values rebased (Feb 1999 = 100)



## PSU monoliths that have delivered market-beating returns are in a minority

10-year compounded annual return (%)

Company	Sector	10-year compounded annual return (%)
Container Corporation	Freight	15
Power Grid Corporation	Power transmission	14
Nalco	Aluminium	14
<b>BSE Sensex</b>		<b>13</b>
IOC	Oil refining	12
SBI	Banking	9
NHPC	Hydro power	9
GAIL	Natural gas	8
Power Finance Corporation	Power financing	8
NTPC	Power generation	3
SAIL	Steel	2
Coal India	Coal mining	1
National Fertilizers	Fertilizers	-3
BHEL	Engineering goods	-11
New India Assurance	General insurance	-23

1. Data as of 17 March. 2. Four-year compounded annual return for New India Assurance, as it was listed in 2017 only. 3. Companies arranged in descending order of returns.

## Distributing Profits

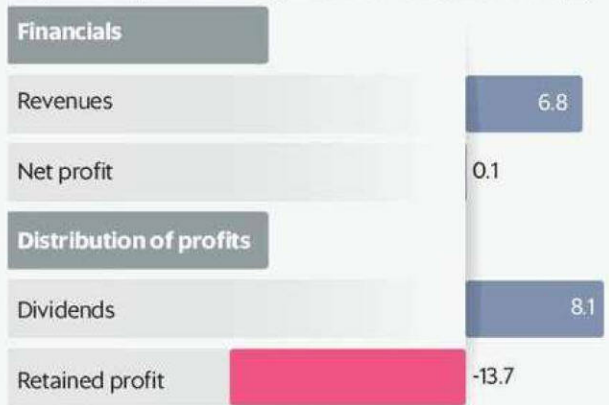
**OVER LONG** periods, shareholder returns tend to track operational performance. On that count, the set of 366 PSUs owned by the central government exhibit worrying signs and also offer clues on the stock market's apathy towards them. In the 10-year period to 2019-20, the latest data available, the revenues of this set has grown at an average 6.8%.

In other words, it has barely beaten inflation. Cumulative net profits have not grown at all.

Despite flat profits, this set of companies has progressively been distributing more of its surplus as dividends to its shareholders, led by the central government. In 2009-10, central PSUs paid out 36% of their cumulative net profit as dividends. This figure more than doubled to 77% in 2019-20. Thus, the surplus that PSUs are able to retain for themselves, to strengthen and expand operations, has declined by an average of 13.7% in the last 10 years.

### Amid growth pangs, PSUs are distributing more profits and retaining less

10-year compounded change in set of 366 Central PSUs (%)

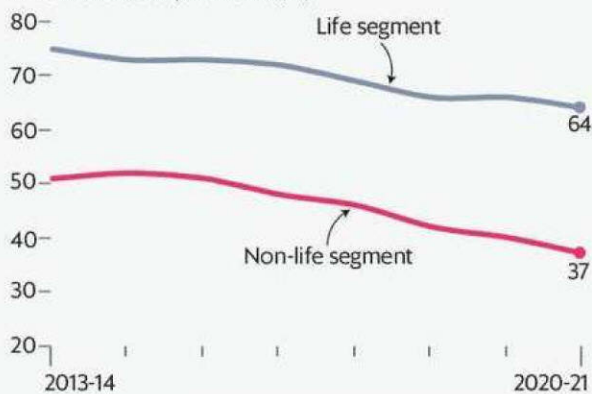


Change between 2019-10 and 2019-20, the latest available.

Source: Public Enterprises Survey, Department of Public Enterprises

## Government-owned insurance majors are losing share to private peers

Market share of government-owned insurers in terms of total premiums (%)



Source: Insurance Regulatory and Development Authority

## Growth Pangs

**THE SET** of 366 central PSUs outlined earlier exclude banks and insurers owned by the government, but even these have their own challenges. An avalanche of bad loans has curtailed the ability of public sector banks to extend new loans. The loan book of State Bank of India, the leader, grew an average of 12% in the past 10 years. Leading private peer HDFC Bank grew at 21.6%. In 2010-11, SBI's loan book was 4.7 times that of HDFC Bank. In 2020-21, it was 2 times. Similar realignments are under way for the four government-owned general insurers. Between 2013-14 and 2020-21, their total premiums grew an average 9%, against the 12% of full-stack private peers. In industries with level-playing fields, government-owned entities are shedding market share to nimble private rivals. In life insurance, the share of LIC has fallen from 75% in 2013-14 to 64% in 2020-21. In general insurance, the share of public sector insurers has dipped from 51% to 37%.

## Legacy Advantages

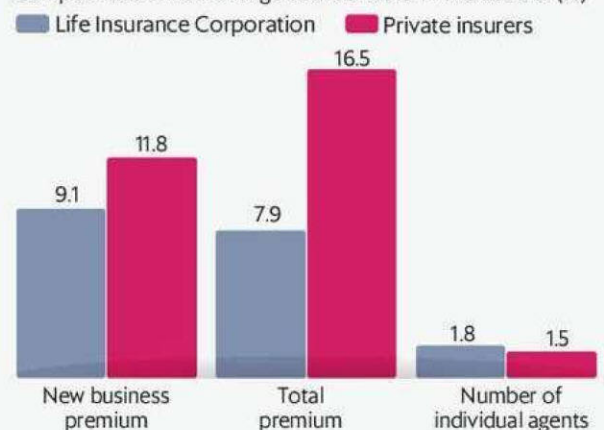
**YET, ALONG** with burdens of legacy, government-owned entities also have a formidable carry-forward of a business base and immense brand recall. LIC, for example, still draws two-thirds of new life insurance premiums collected by the entire industry. A big reason for this is its network of individual agents, who brought in 95% of LIC's new business in 2019-20. LIC has about 55% of the individual agents in the industry. As a result, it is still competing well on growing new business premiums.

For entities such as LIC, the interplay between leveraging established advantages and competition from fleet-footed private players will determine their growth trajectory and the returns they will deliver in the long run. PSUs house businesses that are formidable and relevant to daily lives. Many have built on their advantages to deliver worthy shareholder returns. But, size and scale alone are not markers to identify them.

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### LIC's army of individual agents have helped it keep pace on new premiums

Compounded annual change between 2013-14 and 2020-21 (%)



Source: Insurance Regulatory and Development Authority