

# Raw deal for fertilisers

Survival of the fertiliser industry depends on extension of retention pricing and subsidy, says Uttam Gupta

**T**HE unprecedented under-subscription — to the extent of 85 per cent — of the recent Rs 400 crore issue of the Chambal Fertilisers and Chemicals (CFCL) has produced litters in the financial circles. So much so that the financial institutions refused to pick up the shares even at a discount. Reportedly, the issue has finally gone through the devolvement route.

Consequent to substantial liberalisation of the capital market and in the present atmosphere of a majority of the companies joining the race to raise funds despite lack of investors' confidence and liquidity, there have been a spate of devolvements. However, a close scrutiny of the underlying circumstances will bring out that CFCL's case has been exceptional.

Unlike most of the other companies demanding a hefty premium, Chambal's FCD's were issued at par. Moreover, the public would have put their hard earned savings into the hands of a promoter whose track record in respect of running a host of companies was excellent. The issue would have enthused even the most conservative investors. And yet, the performance was dismal. Clearly, this reflects something more fundamental than the overall investment environment.

The project for which funds were sought will produce urea, an important nitrogenous fertiliser. Besides distribution, the selling price of this product is controlled by the government and kept at a low level. Presently, this is Rs 2,760 per tonne (excluding local taxes) and is only 17 per cent higher than the level of Rs 2,350 per tonne way back in 1981.

The Government also runs what is popularly known as the retention pricing and subsidy scheme. Under the scheme, it allows to the unit its reasonable cost of production and distribution by fixing retention price, equated freight and distribution margin based on prescribed norms. On a weighted average basis for the industry, this should work out to about Rs 4,500 per tonne. The difference between the retention price fixed for the unit and the controlled selling price is reimbursed as subsidy to the manufacturer.

Because of the much higher investment cost due to inflation and steep depreciation of the rupee, the reasonable cost of production and dis-

tribution of CFCL's urea is unlikely to be less than Rs 8000 per tonne. Quite clearly, on being subsidised to the extent of the difference between this and the controlled selling price, the project should be able to earn a reasonable profit. The precise level will depend amongst others, on capacity utilisation, energy consumption, overall efficiency in the management and maintenance of the plant on the one hand and the manner in which the RP and subsidy scheme is administered on the other.

Generally, plants have faced problems in the past, particularly regarding

price and the much higher cost of production and distribution. Decontrol would mean automatic withdrawal of subsidy support and the manufacturer's realisation will be restricted only to the price that the farmer pays.

If the industry has to survive, the price should at least be Rs 4500 per tonne, the weighted average for the industry. That would translate to about 63 per cent more than the present selling price. However, it is most unlikely that the farmer would be willing to pay anything more than Rs 3500-4000 per tonne. Inevitably, a

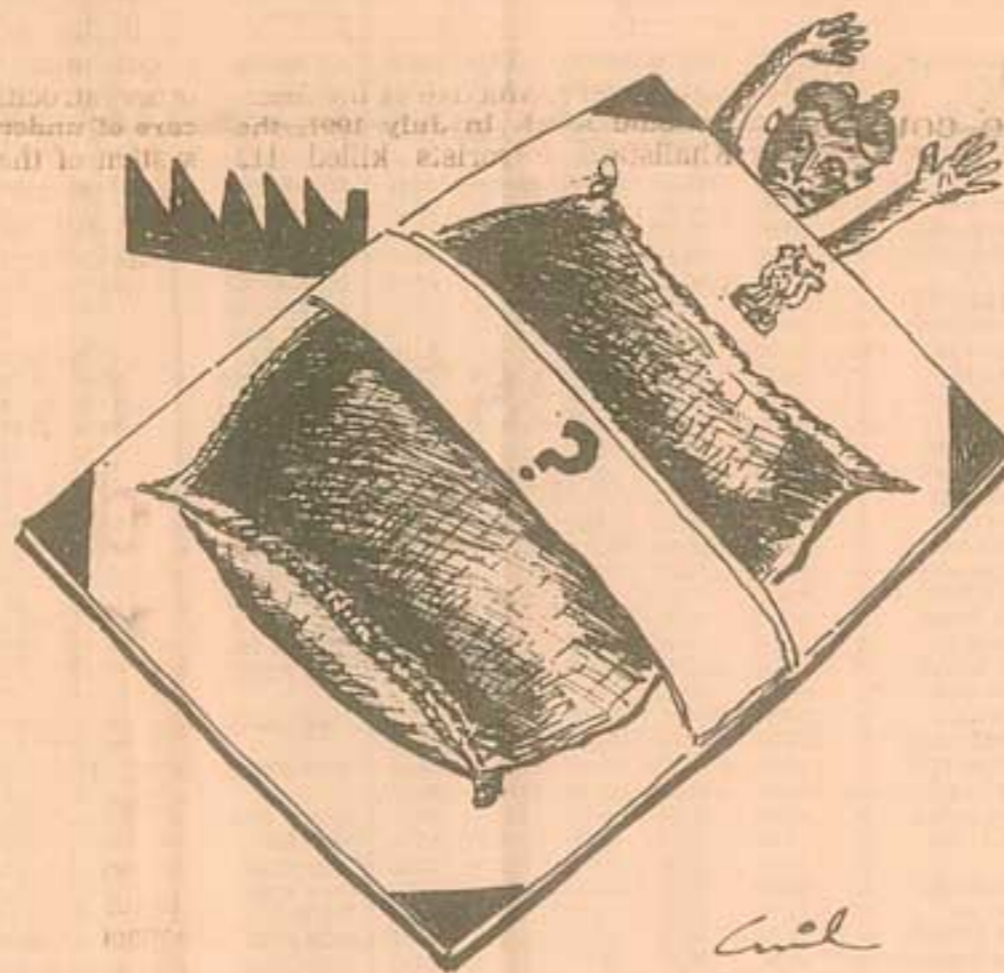
India preparing to negotiate a fresh loan from the IMF, the issue has again been reactivated. Having already ready decontrolled phosphatic and potassic fertilisers in August, 1992, now it seems to be the turn of urea. Some time ago, the government was reportedly contemplating a Rs 800 increase in the per tonne selling price in July 1993, followed by decontrol next year. Informed public opinion has taken these signals seriously. The investing public is no exception — viz the Chambal fiasco, the fate of the Nagarjuna issue last year as also the declining trend in values of all fertiliser shares.

At stake is investment and growth in this vital sector of the economy. During the last five years or so, there has hardly been any increase in the installed capacity of nitrogenous fertilisers, nor any new investment. The nation is already paying heavily for this, as urea imports surged from almost nil in 1990-91 to 400,000 tonnes in 1991-92, 1.8 million tonnes in 1992-93 and now the proposed 3.5 million tonne during 1993-94.

If the public at large has decided not to invest their funds in fertiliser projects, it is primarily an expression of lack of faith in the government's fertiliser policies. Or else, how would one explain the unimpressive results of even the most efficiently performing companies, the steep decline in their share prices, exceptionally poor response to public issues and, above all, the absence of any motivation to invest in this industry.

Removal of control and subsidy on urea could be disastrous for the industry, farmers and above all Indian agriculture. The JPC report on fertiliser pricing sought to confirm this when it recommended continuation of controls on all nitrogenous fertilisers including urea. The finance minister too provided Rs 3,500 crore towards subsidy on this account in the 1993-94 budget.

But then, apprehensions of the investing public need to be allayed. The government can do it by announcing its categorical commitment to continuation of controls on urea and the RP and subsidy scheme as also its implementation in a just and fair manner. At the same time, the JPC recommendations to check the growth in subsidy need to be implemented in toto, to ensure that the bogey of sudden decontrol does not raise its ugly head again.



delay in payment of subsidy, consideration of escalation claims, and adjustment in the conversion and capital related cost etc. Such delay results in uncompensated interest burden.

The new gas based plants in particular, (CFCL is one) will have to cope with additional adversities such as the contemplated move based on the JPC recommendation to deny capital related charges on production in excess of the 110 per cent capacity utilisation.

Notwithstanding these, most of the units would still prefer a controlled dispensation; not because they are shy of facing the forces of competition, but primarily due to the wide gap that currently exists between the "unrealistically" low controlled selling

price and the much higher cost of production and distribution. Decontrol would mean automatic withdrawal of subsidy support and the manufacturer's realisation will be restricted only to the price that the farmer pays.

Even at about Rs 4,500 per tonne, a plant like CFCL will hardly be able to meet its loan repayment obligation, leave alone give any return to the shareholders. Besides Nagarjuna (commissioned in early 1992), this holds for the two other gas based projects currently under implementation as also for the fresh investment, including expansion, projects.

Ever since the economic reforms started two year ago, there has been persistent pressure to eliminate fertiliser subsidy. Indeed, this was one of the conditions for the IMF loan of October, 1991. Now, with