

# Infrastructure Financing Betting Big on India

Funding India's huge infrastructure needs is a formidable challenge for both domestic and international financiers. But, reports **Rajeshwari Adappa Thakur**, many are queuing up to be a part of the growth story

**T**he bill for building India's infrastructure works out to \$350-odd billion. The good news is that raising the required resources may be a formidable but not an impossible task. Especially since Indian and foreign infrastructure players and investors including private equity funds are queuing up to be a part of the growth story as India opens up its infrastructure sector.

"Funds are not an issue for good, bankable projects," affirms Hemant Joshi, executive director and chief operating officer, CRISIL Ltd. International infrastructure majors like CLP, AES, Korea Electric, Malaysian firm IJM Corp along with investors like financial powerhouse Citigroup and private equity firm Blackstone Group Holdings L. P. all have one thing in common: they believe India is the place to be in at present.

If the success of the mobile telephony sector is anything to go by, they sure seem to be betting right. After all, private equity fund Warburg Pincus netted over \$1.6 billion on its \$292 million investment in mobile service provider, Bharti Airtel in 2005. More recently, Vodafone bought out Hutchison's 67 per cent stake in Hutch Essar at \$18.8 billion including debt.

"Foreign capital has played a big role in the development of the Indian

telecom sector as few Indian business houses had the deep pockets required by the sector in the early days," points out Sanjeev Aga, managing director, Idea Cellular.

The flow of investment hinges largely on the policy and regulatory environment. "Clarity on policies is critical for investments," notes Joshi. "India is an opportunity area. In more and more sectors, the regulatory environment is falling in place, so the attractiveness has increased."

Given the future potential of the sector, infrastructure is the current favourite of domestic companies too like Reliance Industries, GVK, GMR, the ADA group and others.

The entry of the private players in a big way augurs well for the sector where the investment need far exceeds the amounts provided for in government's budgetary allocations. The total annual capital investment on infrastructure still hovers around 4 per cent of GDP compared to over 10 per cent share in some other Asian countries.

India's infrastructure needs are estimated at about \$350 billion over the next five years. Of this, given a debt-equity ratio of 70:30, about \$250 billion of debt and \$100 billion of equity needs to be raised over a five-year period.

It is estimated that about 25 per cent

of the total funds would need to be raised from the private sector. Of the \$100 billion equity, about \$25 billion would have to come from the private sector over the coming five years, thus translating into roughly \$5 billion per year.

"The total investments during the period 2008-12 is estimated at \$60 billion for roads, \$75 billion for power, \$22 billion for telecom and \$10 billion for ports," says Natarajan Narasimhan, head of research, Crisil Research. This is almost double the investments seen during the period 2003-07 (see table) in most cases, except in the case of telecom.

The amount of funds required is huge and cannot be funded from budgetary resources alone. India's Finance Minister, P Chidambaram, earlier noted: "One has to reach out to the private sector and private savings and to the other mechanisms available in the market today to raise funds to fund such an ambitious infrastructure project."

In the past, the infrastructure projects were mainly financed through budgetary allocations, grants by state or central governments and long term debt provided by the leading development financial institutions like IDBI (Industrial Development Bank of India) and ICICI.

The fear that private operators might exploit the natural monopoly of the

utilities and other infrastructure services was why these services were kept within the purview of the public sector units. Thus, Bharat Sanchar Nigam Ltd and Videsh Sanchar Nigam Ltd were monopolies that provided landline telephony and international telephony services respectively, till the telecom sector was opened to private participation.

The funding of the projects, then and now, also depended on the nature of the project and whether the sector fell under the purview of the state or the central government. For instance, aviation and railways fall under the Centre while power falls under the concurrent list (that comes under both state and the Centre).

But these proved to be inadequate and the lack of infrastructure started to hurt the economy. According to estimates, the gap in infrastructure is costing India between 1.5-2 per cent of GDP growth every year.

Following the economic reforms, several steps were taken to spur growth in the infrastructure sector. A specialised financial intermediary for infrastructure was incorporated in 1997 called IDFC (Infrastructure Development Financial Corporation).

In 2005-06, IDFC accounted for an estimated quarter of all private sector focused infrastructure project financing in the country. In the past two years, IDFC has contributed to the financing of 3,600 MW of additional power generating capacity. In roads and ports, IDFC has helped finance about 1,000 km of new roads and 3.5 million tonnage of additional port capacity.

IDFC Private Equity, a 100 per cent subsidiary of IDFC, manages an infrastructure focused private equity fund in the country with a corpus of \$636 million.

Following the conversion of the erstwhile development financial institutions (DFIs) into commercial banks – namely, IDBI Bank and ICICI Bank – infrastructure projects faced the problem of securing long term debt. While banks continue to lend to infrastructure projects, they provide loans of shorter maturities.

“Unlike other sectors, infrastructure financing needs long tenure debt of more than 10 years. This leads to an



**TOWERING FUNDING NEEDS:** Infrastructure financing needs long tenure debts of over 10 years



**WIDENING THE NET:** Infrastructure projects source external commercial borrowings

asset-liability mismatch since the monies raised by banks have a shorter maturity of about 6-9 years," says Vinayak Limaye, executive director, corporate finance, new products and new businesses, IDFC.

In order to mitigate this problem, the Indian government has set up another institution, Indian Infrastructure Finance Corporation Ltd (IIFCL), to secure long term debt for infrastructure projects. IIFCL has the ability to borrow up to \$2.32 billion that will be guaranteed by the government.

Apart from this, IDFC, Citigroup, IIFCL and Blackstone in February launched the 'The India Infrastructure Financing Initiative' that will deploy \$5 billion in capital for infrastructure projects in India. IDFC, Citi and Blackstone will each invest \$75 million while IIFCL will invest \$25 million in the equity fund, taking the total investment to \$250 million. The balance is being raised from international and domestic institutional investors.

Finance Minister Chidambaram described the financing initiative "as an important milestone in our search for innovative solutions to meet the vast challenge of financing the development of India's burgeoning infrastructure sector."

"IIFCL can invest up to 20 per cent of the project cost," noted chairman, S S Kohli, while announcing alliances with three banks, Indian Bank, Oriental Bank and Corporation Bank.

Apart from institutional funds, infrastructure projects today also use external commercial borrowings (ECBs)



**Hemant Joshi**, executive director and chief operating officer, CRISIL Ltd

to raise resources. But there is a cap on the amount of ECBs that can be raised currently.

There is a need to widen the net further and look for more creative solutions for funding. One such idea was suggested by the finance minister in his budget speech: to use forex reserves for meeting long term capital needs. However, the Reserve Bank of India (RBI) is yet to take a decision on the same.

**Investments in Key Infrastructure Sectors**

Sector	FY03-07	FY08-12
Power	48	75
Roads	29	60
Telecom	24	22
Ports	4	10

Figures in \$ billion (2006)

Source: CRISIL Research

While pointing to the need for tapping different sources of capital, Limaye also recommends the use of insurance and pension money. "The long term liability of insurance and pension funds is a natural fit for infrastructure projects that have a long gestation period," he adds. But this requires changes in investment norms.

The development of a robust bond market will also aid in creating alternative avenues for financing of infrastructure. Besides, the regulations regarding securitisation also need to be changed to make it more attractive to the players. Many are hopeful that over the next couple of years, the government will usher in reforms that will provide greater flexibility while raising resources for infrastructure projects.

"The savings growth rate is quite good in India, but there is a need to channelise this savings into financial savings," explains O. V. Bundellu, deputy managing director, IDBI.

The government is increasingly looking at using the public private partnership (PPP) model to fund infrastructure projects (see box). Private players have been involved in many infrastructure projects that are being implemented on a build, operate, transfer (BOT) or build operate, own and transfer (BOOT) basis. Most of the road and bridge projects have been implemented successfully using such BOT or BOOT schemes.

The increasing interest of the private sector in infrastructure projects is in inverse proportion to the risks associated with these projects.

Foreign investors are comfortable with the idea of investing in Indian infrastructure as the risk returns ratio is comparable with that of most other developing markets, feel some. While some players said that the average internal rate of return (IRR) on infrastructure projects in India is about 15-18 per cent, others said it was higher at about 20 per cent plus.

Thanks to the higher comfort levels, foreign investors no longer seek guarantees from the state and central governments in return for investments.

Infrastructure funding has come a long way in India. The biggest positive in the case of infrastructure projects is

## OF PPPS, BOTS AND BOOTS



Necessity is the mother of all inventions. It was the need for an assured source of regular water supply by the water-intensive textile dyeing and processing units of Tirupur in the southern Indian state of Tamil Nadu that led to the setting up of South Asia's first public-private partnership in the water and sanitation sector. The result: Tirupur residents, who earlier received water on alternate days, started receiving water everyday for about 4-6 hours.

The slow pace of infrastructure growth in the past led to the realisation that an alliance between the public and the private sectors is the only solution to spur growth of infrastructure in the country. The Tirupur project is a great example of the benefits of involving the private sector in what would earlier have been considered a problem that falls under the purview of the public sector.

Public Private Partnership (PPP) project means one based on a contract or concession agreement, between a Government or statutory entity on the one side and a private sector company on the other, for delivering an infrastructure service on payment of user charges.

PPPs are not a recent phenomenon. The first example of a PPP, internationally, is that of the Water Works Company of Boston, which is said to be the first private firm in America to provide drinking water to citizens way back in 1652.

PPPs are essentially win-win solutions that seek to draw on the strengths of both sectors. Thus, the efficiencies of the private sector can ensure better de-

liveries of public infrastructure like roads, bridges, water supply and sewerage projects, ports and airports, etc. The presence of the public sector ensures certain concessions, and mitigation of some of the risks. Thus, the combined capital and intellectual resources of the public and private sectors can result in better, more efficient services, without raising taxes for the public.

Raising the large amounts of funds necessary for infrastructure projects, especially in these times of fiscal prudence, requires the participation of the private sector. The government has also taken the initiative to provide Viability Gap Funding (a grant one-time or deferred, provided with the objective of making a project commercially viable).

The PPP model is being used to finance many projects in India, including the dedicated freight corridors on Delhi-Howrah and Delhi-Mumbai routes, Greenfield airports in Bangalore and Hyderabad and modernisation of the Mumbai and Delhi airports.

The Economic Survey for 2006-07, the annual report card on economic issues released by the government, has stated that PPPs can contribute vastly to the growth of infrastructure.

The PPP model has proved successful in the roads sector. Thus, while the first phase of the National Highway Development Programme (NHDP) was mostly funded by the National Highway Authority of India (NHAI), in the second phase – north, south, east and west (NSEW) – of the 37,300 km of highways upgradation, about 1,100 km was funded through the Build Operate and Transfer (BOT) scheme, one of the forms of PPP used in India.

Schemes like the BOT and the BOOT use the revenues that accrue from tolls collected from road or bridge users to offset a part of the cost of the project.

Apart from the Central government, the state governments too are likely to use the PPP model for upgrading urban infrastructure including urban roads, mass rapid transit systems, urban water supply systems, solid waste management and others.



O V Bundellu, deputy managing director, IDBI

the change in the mindset of the people. "The model of toll roads where one has to pay for service has been accepted," says Bundellu. The concept of toll roads had met with a lot of opposition when they were first introduced.

The success of telecom has been partly that the sector has been able to collect revenues from the user. Compared to other infrastructure sectors, the telecom sector has fared better with investors and telcos fighting over each other to get a toehold in the sector. "Today sourcing funds for the telecom sector is easier since the sector that is now nine years old, has a proven business model with cash flows, but the story was different in the early days," notes Aga of Idea Cellular.

India has a long way to go given the lack of adequate infrastructure across cities, towns and rural areas. Besides, India has the potential to absorb \$150 billion of investment in the next few years in the infrastructure sector alone.

Infrastructure financing is much like a game of cards where deep pockets and loads of patience can prove to be a winning combination.

As to who will be the ultimate winner, only time can tell. But all would be eagerly waiting to see who will replicate Warburg Pincus's jaw dropping story in the power, roads and other infrastructure sectors. 🌈