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Innovative Infrastructure Financing Strategies In India

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Introduction:

Infrastructure is fundamental to both economic development and plays a crucial role in determining the quality of life of individuals and societies. In almost all parts of the world the need for new infrastructure assets or the need to moderniseobsolescent assets are stark. However, we live in a world where economic and demographic growth, coupled with severe underinvestment in infrastructure, has created an infrastructure deficit that some estimate would require an annual investment of over USS 2 trillion each year over the next 20 years.

Due to the necessity of private sector participation and the need for incurring heavy institutional debt, since December 1992 the Reserve Bank of India (RBI) has been encouraging banks to have more exposure to financing infrastructure projects. The RBI has also relaxed individual and group exposure norms from 5 to 10 per cent of banks[1] capital funds in the case of lending to infrastructure sector for single and group borrowers respectively. It has also relaxed norms for classification of infrastructure assets as Non Performing Assets (NPA's). RBI has allowed the banks to use the take out financing mechanism to bridge the asset liability mismatches, issue long term bonds to fund infrastructure, invest in bonds issued by unrated Special Purpose Vehicles (SPV's) of infrastructure companies, subject to a maximum ceiling of 10% of non SLR investments, keeping the promoters shares in infrastructure SPV's out of capital market exposure norms and allowing banks to fund promoters equity.

Lately, RBI has also demarcated commercial real estate from non commercial real estate based on the source of repayment rather than collaterals. The RBI wants banks to step in to fill up the position vacated by the Development Financial Institutions (DFIs). This makes sense as the DFIs

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as a class is becoming extinct, except for a few remaining ones. The RBI's move is to garner the surplus in the banking sector and utilize it for building the nation's infrastructure assets. The banking sector has been showing a CAGR of almost 30% year on year growth in lending to infrastructure and infrastructure has almost a 33% share in industrial credit by banks. The deployment of gross bank credit to Infrastructure stands at Rs3,52,360 crores. (Handbook of Statistics on Indian Economy, RBI)

Collaboration with the Financial Services and Investors Industries - Participation and active engagement in projects initiated by the Financial Services and Investors Communities, including:

- *Rethinking Financial Innovations*
- *Globalization of Alternative Investments*
- *The future of Long-term investing*
- *Redefining the Emerging Market Opportunity*

Infrastructure Development and Finance –

The infrastructure focus in 2009 and 2010 had been on maximizing the effectiveness of fiscal stimuli on infrastructure and on attracting private capital into the infrastructure asset class. In 2011 the focus of the initiative will be on driving a shared understanding and vision of the economic competitiveness impacts of infrastructure investments and in implementing infrastructure investment strategies based on that shared vision

Objectives of the Study:

> The primary objectives of creating an incentive framework should be to benefit consumers. '

> The secondary objectives could relates to reduction in national debt, stimulation of

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domestic capital markets, improved quality of services etc.

Literature Review:

Stiglitz(1996), infrastructure refers to all those activities and facilities, which help to generate, sustain and enhance, directly or indirectly, the growth in production and income generation within the infrastructure enterprises themselves because of the multiplier effects of such investment. More generally, it encompasses all institutional prerequisites of efficient working of competitive market and expansion in production.

Montek S. Ahluwalia (1998) stressed "Public recognition of the need for private investment in infrastructure (which helps to reduce perceptions of political risk), a structure of tariffs which can assure remunerative return for investors, cJarity of government policy and transparency of procedures governing the interface between private investors and various public authorities to reduce uncertainly and finally, establishment of independent regulatory agencies charged with ensuring fair treatment for private investors.

The Economic Survey 2011-12 said delay in infrastructure projects may affect competitiveness of the economy in long run and called for and "new models of financing" the sector whose funding requirement in the 12th Plan is estimated at around USD 1 billion.

"In view of the massive requirement of funds, all efforts need to be made to attract big-ticket long-term investors such as strategic investors, private equity funds, pension funds, and sovereign funds," the Survey tabled in Parliament today said. It added that "there is a need for introducing more innovative schemes to attract large-scale investment into infrastructure. Strengthening domestic financial institutions and development of a long-term bonds market may be critical". Stating that 50 per cent of the projected investment will come from the private sector in the next Five Year Plan, **the** survey **said,** "financing infrastructure will, therefore, be a big challenge in the coming years and will require some innovative ideas and new models of financing". Taking a cue from the realisation of investment targets for

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infrastructure during the current Plan, the survey expressed hope that financing of the ambitious 12th Five Year Plan investment target would be possible.

According to the survey, the bank credit to the projects in the sector had witnessed a healthy growth of 48.4 per cent per annum during 2006-11, increasing from Rs 30,286 crore during 2006-07 to Rs 146,767 crore during 2010-11. However, the credit growth has turned negative in the current financial year and at Rs 70,155 crore, net credit to the infrastructure sector during April-December 2011 was nearly 61 per cent lower than the same period of last fiscal, it noted. The survey also called for "a conducive environment for private sector participation with a transparent and credible regulatory mechanism" for financing the infrastructure projects, so that to reduce the pressure on public-sector funding. Emphasising that the performance in core infrastructure sectors is still to a large extent dependent on public sector projects, it said that in the next Five Year Plan, the public sector investment will need to increase to over Rs 22.5 lakh crore, a rise of over 71 per cent than the current Plan. Noting that out of 583 projects in different infrastructure sectors, 235 are delayed as on October, 2011. and have seen cost overrun of 15.3 per cent cumulatively, the survey said that the sector has also suffered due to a time lag in the physical capacity creation and time over runs. "These not only deiayavailability, but through cost overruns raise pricing and affordability issues."

The Challenge of Financing Infrastructure in Developing Countries

Efficient transport, reliable energy, safe drinking water, and modern telecommunication systems are critical to attracting foreign direct investment, expanding international trade, and achieving long-term investment and growth. Worldwide, most future infrastructure demand is likely to come from the developing world (home to 85 percent of the world's population), Where access to infrastructure services falls well behind the levels in the developed world

Global capital markets have the depth, maturity, size, and sophistication *potentially* to fund all viable investments and projects in developing countries' infrastructure. That they have failed to do so, and that the flow of private finance to infrastructure has declined so

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dramatically in recent years, is a reflection of several factor chief among them the impact of recent macroeconomic shocks, ongoing transformations in the global electricity and telecommunications industries, the weakness of local capital markets in most developing countries, and unfinished reforms needed in many developing countries to place their infrastructure industries on a commercial footing.

Recent developments in private financing

The investment opportunities that came with the wave of privatization and liberalization in the early 1990s encouraged major international project operators and contractors facing poorer growth prospects in their home countries to invest in power plants, roads, and telecommunication facilities rn the developing world. The entry of multinationals in the infrastructure sectors, which had traditionally been closed to international competitors and private participation, implied a process of learning, experimentation, and bargaining by firms and host governments. Firms had three comparative advantages in overcoming the barriers to entry in developing-country infrastructure.

- First, the utilization of modern technology, particularly in the telecommunications sector.
- Second, access to capital at a lower cost than that available to host countries' governments.

And third, a capacity to operate at a global level, implying, among other things, an ability to draw on synergies involved in structuring business relationships in the form of joint ventures, consortia and special-purpose vehicles

Expansion was initially fuelled by optimistic expectations about demand, the commitment of governments to contractual terms, the credit quality of project off-takers, consumers' ability to pay, and, above all, the stability of macroeconomic conditions. In the transport sector, *for example,* Standard and Poor's studied 32 toll roads worldwide, finding that traffic forecasts

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were too high in 28 cases actual traffic volumes averaged only 73 percent of the forecast (Bain and Wilkins 2002). In the power sector, state-owned enterprises commonly entered into long-term power-purchase agreements on the understanding that those agreements would be guaranteed by a tariff indexed to hard currencies, such as the dollar, over the contract's entire life, backstopped by government guarantees. As those expectations proved overoptimistic, capital flows to developing-country infrastructure began to decline. Meanwhile, capital flows to infrastructure remain concentrated in a small number of countries.

Conclusion:

India is one of the world's most promising and fastest-growing economies, and multinational companies are eagerly investing here. Banks and financial institutions need to mobilize domestic savings with innovative instruments. With the enormous task ahead, there is a need to top capital market through innovative credit rating system, launching of innovative borrowing instruments, development of an active secondary market in securitized assets. Restructuring and regulatory reform progresses, monitoring and evaluation system to track unfolding development.