THE INFRASTRUCTURE SECTOR IN INDIA

Past, Present and Future

The infrastructure sector in India has evolved from purely Government funded projects to newer business models involving partial or complete ownership of the private sector. Currently, the infrastructure sector is in a state of flux, with the sector being hit by the slowdown in the economy and the strain being faced by various infrastructure developers. Going ahead, the sector is poised to bounce back with new opportunities. The renewed sense of optimism by the industry leaders augurs well for the future growth of the infrastructure sector. But the growth of the infrastructure sector is dependent on solving some key challenges related to reducing regulatory uncertainty, developing appropriate financing mechanisms and ensuring efficient project management (from bid to execution) feels Susnato Sen, Practice Head – Infrastructure & EPC, and Anirudh Reddy, Project Leader, Tata Strategic Management Group.

Susnato Sen

INFRASTRUCTURE DEVELOPMENT – PAST VERSUS PRESENT

There has been a growing emphasis on infrastructure development in the post liberalisation era. This is in stark contrast to previous years where there was little emphasis on infrastructure asset creation, with government being both facilitator and provider of infrastructure. But this situation has undergone a change in recent years, with an increased focus on infrastructure development. The start of the last decade has witnessed increased investments in infrastructure sector, accompanied by a transformation in the business models with more proactive participation from private sector in the form of Public-Private-Partnership (PPP) projects, particularly in roads and power sector.

The Gross Capital Formation (GCF) (as an indicator of investment in infrastructure) grew from 5.6% of GDP in FY07 to 6.5% of GDP in FY12. Overall share of investment in infrastructure (as a share of GDP) over the XIth Plan period was 7.1%, up from 5% in Tenth Plan. The share of private sector participation in the XIth plan, envisaged at ~ 30% at the start of the plan, was ~ 37% during the Plan duration.

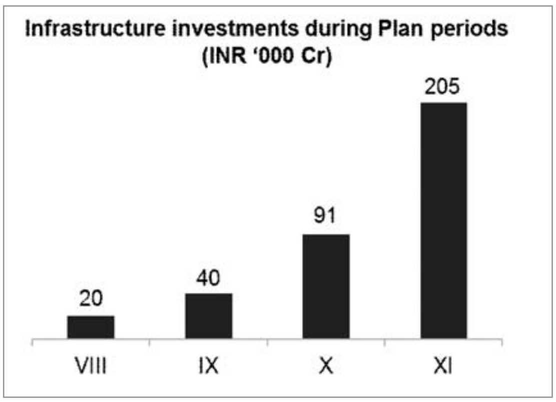
RISKS / CURRENT CHALLENGES IN INFRASTRUCTURE DEVELOPMENT IN INDIA

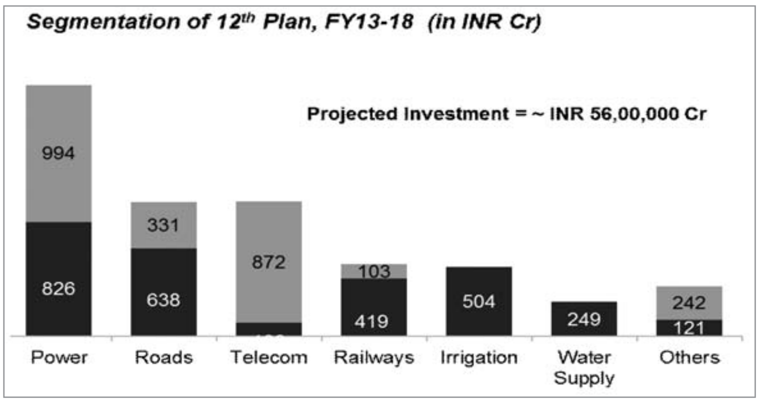
But the progress of infrastructure development has not been smooth in the recent years, with significant shortfalls in planned investments. This problem is compounded by the fact that many of the announced projects are yet to be completed, with large time and cost overruns. Figures sourced from Government reports reveal that nearly 276 projects out of 566 projects tracked by Ministry of Statistics and Programme Implementation have been delayed. Some estimates of Ministry of Finance peg the worth of delayed projects, due to pending approvals, at ~ INR 1 lakh Crore.

Some of the key issues plaguing the sector are:

1. Land acquisition and environmental clearance
2. Lack of coordination between various Government agencies
3. Inappropriate structuring of the projects, particularly of demarcation of risks and rewards between Government and private sector
4. Lack of a proper dispute resolution mechanism between private players and government agencies
5. Debt burden of infrastructure developers, as a consequence of execution delays and irrational bidding

A number of firms have had their debt recast by corporate





Source: Planning commission reports, Govt. of India

Anthony azavedo

debt restructuring cell, with some firms resorting to sale of BOT assets to reduce their debt burden, post award of the project. This has also delayed project implementation. The order inflows for large infrastructure firms have declined over the past 1-2 years. The appetite of infrastructure developers for new projects has significantly reduced. This has resulted in very lukewarm response to bids from the government agencies like NHAI in the PPP route. Banks are also being cautious in lending to infrastructure sectors, where exposure limits have already been reached.

Mittal Shah

FUTURE GROWTH AREAS FOR THE SECTOR

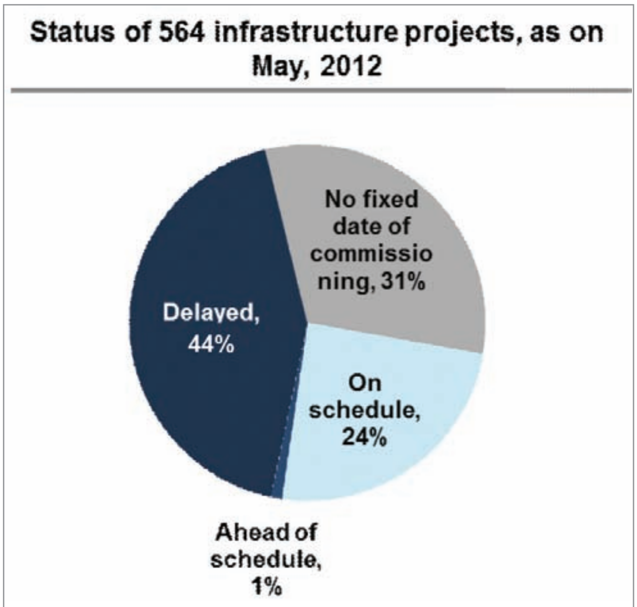
The proposed investment over the next five years are ~ INR 56,00,000 Cr, with nearly half expected to come from private players. While sectors like road and power are expected to attract a large share of the proposed investments, newer opportunities are likely to appear over the next few years. One of the examples of a large planned infrastructure development is the Delhi-Mumbai Industrial Corridor, envisaged to accommodate large industrial zones, development of smart cities and creation of logistics network. A sector that has lagged behind some other sectors, in terms of award of projects and private sector investment, has been Railways. This sector is expected to grow in the coming years, given the requirement of developing multi-modal logistics infrastructure, including port connectivity projects, high speed rails etc. Opportunities are also expected to arise in the area of urban infrastructure development, such as large urban transport and water supply projects in urban cities, driven by the rapid pace of urbanization.

IMPERATIVES FOR FUTURE INFRASTRUCTURE DEVELOPMENT

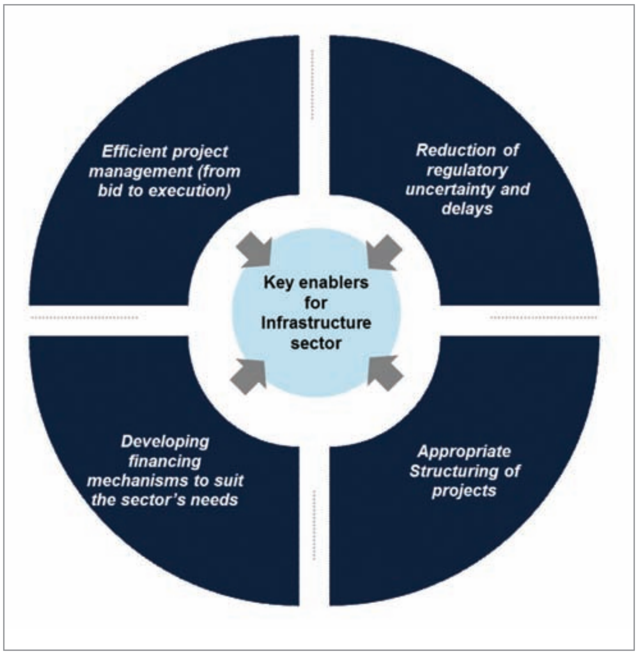
But for the aforementioned forecasts to materialize, the sector requires significant intervention accompanied by an overhaul of the current way of doing business across the various participants - Developers, EPC players, Government etc. Although the current economic scenario has slowed down the development of the sector, government would need to explore ways of keeping the sector moving. Government has made some progress on key issues, but much still needs to be done. There have been mixed reactions to Land Acquisition Bill, with some viewing it as potential cost escalation, while others treating it as a tool for improved transparency on the subject. Another area that needs urgent Government action is the need for improved access to key natural resources like coal and iron. But for the sector to rebound in the coming years, there is a need for decisive action and support over four broad areas.

I. REDUCTION OF REGULATORY UNCERTAINTY AND DELAYS

The Government needs to create a mechanism for single window clearance for various approvals. This would require a proper regulatory body overseeing the progress of approvals and coordinating with various Government bodies. Efforts are also required to ensure enforcement of contracts in a time bound and transparent manner to attract private investment and FDI. Bodies like the Cabinet Committee for investment (CCI) need to become more proactive to clear backlog of delayed projects



Source: Ministry of Statistics and Programme Implementation



II. APPROPRIATE STRUCTURING OF PROJECTS

Current mechanism of structuring a project as an EPC or PPP or 100% private ownership needs to be relooked to account for varying risk profiles of projects. As private players have become wary about risk-return of projects, Government needs to put in adequate thought on the appropriate mode of project execution. There is a need for creation of a dispute resolution mechanism for the PPP projects. Adequate care also needs to be put in developing contract terms to provide sufficient safeguards for private players from extraneous circumstances.


Anirudh Reddy

III. DEVELOPING FINANCING MECHANISMS TO SUIT THE SECTOR'S NEEDS

Infrastructure companies are finding it difficult to raise funds, as banks have restricted exposure to the sector while funds from abroad are not finding a suitable avenue to invest in the sector. In this regard, long term debt instruments such as international pension funds will reduce the cost of debt and thereby viability gap for infrastructure projects. The proposed new investment vehicles like Infrastructure investment trusts (for securitization of assets) and Infrastructure Debt Funds (being explored by institutions like IL&FS, IIFCL etc.) need to be hastened to provide a fillip to the sector.

IV. EFFICIENT PROJECT MANAGEMENT (FROM BID TO EXECUTION)

Private companies need to evolve their processes to employ best-in-class project management tools and techniques. The bidding and estimation process needs to be tempered with greater emphasis on proper revenue estimates and identification of project risks. Companies need to address issues related to lack of skilled manpower and improve their current sourcing & project management practices, to reduce the incidence of cost and time overruns during execution.

It is now a well-established and acknowledged fact that creation of infrastructure assets is critical for India's economic development. The current post-election scenario has created an air of optimism, due to the promise of stability over the next five years. This is expected to result in an improved decision mechanism that would expedite clearances and address some of the key bottlenecks mentioned above. The opportunities for future growth of the sector are enormous but there are also significant challenges that need to be overcome in order to make this infrastructure dream a reality.

About the Authors

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