CHAPTER-III

INFRASTRUCTURE FINANCE:
EMERGING APPROACHES
“Whenever we go we finally arrive at the portal of governance only. But will the governance take the driver’s seat? This is a million dollar question”.

K. Venkatasubramanian.
Member, Planning Commission.

3.1 Introduction:

The mobilization of required fund and its effective management is the crux of the problem in infrastructure financing. The meager productivity of investments of public owned fund has brought about a rethinking in financing infrastructure. There is an increasing realisation that mobilizations of private fund is a must due to financial constraint of public authority and secondly to induct the concept of commercialization and efficient management in infrastructure sector. Thus, finance holds the key to shift to commercialization of infrastructure. But financing of infrastructure, exhibits some idiosyncratic features, which need be well appreciated to frame appropriate responses thereto.

3.2 Features of Infrastructure Finance:

- Large capital costs, due to large, lumpy equipments as well as extensive delivery networks.
- Substantial sunk costs, which have to be committed before a project becomes operational.
- Long implementation and gestation period, due to large project size and the need for extensive co-ordination.
- Irregular cash flows, because of lumpy investments and restriction regulations on user charges etc.
- High leverage ratio, due to low internal generation and less public equity for its riskiness.
- Long payback period, caused by large investment and long moratorium.
Above characteristics show "hugeness" about infrastructure finance with high risks, large funds, long paybacks etc. Never the less appropriate response has also been evolved. Now greater possibilities of unbundling of infrastructure projects make investments less lumpy. Efficient risk allocation reduces uncertainties involved in sunk costs and long gestation period. More of cost based pricing and innovative supports from the government ensure projects a decent internal rate of return. Projects no longer seek a reversal of the conventional "pecking order of corporate finance", as risk capital is easier to mobilise, if properly structured. If Euro tunnel was debt financed in proportion of 7:1, the IFC assisted projects show a debt equity ratio of only 58:42.¹ Thus investments are no longer illiquid with innovative instruments coming in. So for the infrastructures financers, more important question is risk evaluation and framing of appropriates responses to that.

3.3 Sources of financing Infrastructure:

Infrastructure projects require a large amount of finance by way of equity, debt and mezzanine capital. Usual sources of finances are:

- Public finance.
- Multilateral institutions.
- Bilateral agencies.
- Commercial Banks.
- Infrastructure Funds.
- Capital Market.
- Sundry financiers.

3.3.1 Public Finance: The public sector has supplied more than 90 per cent of investment in our country in infrastructure sector. Public finance of infrastructure comes from taxes and borrowings. But the design and collection of tax revenue is
generally deficient in developing countries with less taxable capacity and high
avoidance. Domestic borrowings are mainly through pre-emption of institutional
funds. Foreign borrowings are by way of concessional aids, which lead to
overspending and therefore there have been and sub-optimal use of public
finance in infrastructure everywhere.

Nevertheless, the public finance remains the single largest mobiliser of
funds with full faith on credit of tax revenues. However, the method of funding
may change from pre-emption in incentives and from contractual saving to
discretionary savings so as to synchronise the needs of investors and borrowers.

3.3.2 Multilateral Institutions: Multinational institutions like World Bank, IFC,
ADB etc. give a supportive finance. More than funds, they need to add values
through loans processing, insurance guarantees, syndication etc. and create
comfort for other financiers through their presence. Their concessional and long
tenure loans are available to public sector against sovereign guarantees.
Commercial loans, especially from IFC, are available in viable projects in private
sector without additional collateral. Purpose specific funds, like Technical
Assistance, Special Fund of ADB are available for project preparation and
development. Their partial guarantees as well as co-financing and
complementary financing facilities with cross default clauses project financers
against sovereign defaults. However, multilateral loans are constrained by limited
availability, need for government guarantee and dilatory process.

3.3.3 Bilateral Agencies: Bilateral agencies extend either development
assistance to government agencies (e.g. US AID) or commercial loans
guarantees and insurance to promote exports (e.g. US EXIM). Loans are made
available by (a) direct lending to importing entity (b) on lending through
commercial banks or (c) interest rate equalization through a bank. Direct lending
of may be through buyer's credit, supplier's credit of or guarantees. Usually, ECA
loans are now available without guarantee or only against suppliers corporate
guarantee, which effectively transfer risks from the host country. In general, such
bilateral loans have advantages of fixed, lower rate of interest for longer term
with low appropriation risk and disadvantages of delay, currency risk and
requirement for government/institutional guarantee.

3.3.4 Commercial Banks: Commercial banks usually offer medium term loan
apart from guarantee and construction finance. Their main attribute is flexibility.
Besides, their experience in risk appraisal and loan structuring helps. Their
guarantee facilitates financial flows. They can take both on-account exposures as
well as syndicate loans from others. Of late, they are able to negotiate risks
through turnkey contracts and innovative structures. Moreover, international
commercial banks can facilitate participation of overseas promoters, contractors
and investors. However, bank loans are constrained by exposure-by-exposure
norms, low appetite and elaborate covenants.

3.3.5 Infrastructure Funds: Such funds may be general or sector specific and
government sponsored or commercial. They are often a mix of financing equity,
mezzanine funds, completion guarantees, bridge financing etc. with a long-term
view. They also leverage by attracting private funds and providing investment
vehicles. Their main utility lies in their willingness to take exposures, albeit at an
aggressively high return. A few examples of such funds are: ABB funding, AES
China, AIG Asian, Asian Infrastructure Funds, Global Power Investments etc.
Now, UTI has proposed telecom fund and other sector specific funds for
investment in infrastructure.

3.3.6 Capital Market- Capital market offers a much wider pool of funds from a
broad range of financial instruments. It also has the benefits of fixed rates,
secondary market liquidity, less covenants and long maturity. However, capital
market funds are difficult to handle project complexities and pricing issues. It also requires an elaborate disclosure, a credit rating, a minimum offer amount and a large floatation cost.

International capital market looks for "credibility markers", i.e., high profile and stable cash flow. Otherwise, only issues with strong sponsors and government support can raise bond capital. As such, for Indian infrastructure projects only the overseas promoters can raise equity/bonds on their credit rating till projects earn confidence.

3.3.7. Public Sector Infrastructure Facility (PSIF): PSIF of $300 million security has been arranged from ADB through ICICI and IFCI. The PSIF is arranged from international agencies by some public sector financial institutions. It would be used for on lending to private sector projects through long terms debts of 15 years maturity with secondary market liquidity. It is expected to promote private sector participation in infrastructure, development of debt market and institutional capabilities.

3.3.8. Sundry Finance: These include all the project partners who provides supplier's credit, buyer's contractor's finance, advance from off takers etc. It provides low cost, discretionary finance tied in project activities. Through subject to less restrictive covenants, it remains an unstable limited source.

3.4 NEW APPROACHES to FINANCING INFRASTRUCTURE: The following are four new approaches to infrastructure financing.

- Concessionaire Approach
- Debt Subordination
- Escrow Accounts
- Mezzanine capital
3.4.1 Concessionaire Approach: - The method has been adopted by many developing countries for attracting private sector funds for infrastructure development. The participation of private sponsors can be depicted on the BOO, BOT and BOOT approaches. These approaches have been discussed in the preceding chapter.

3.4.2 Debt Subordination: - A pool of assets can be divided into senior and subordinated infrastructure. In the event of a default, the senior securities have first claim on assets in the pool as well as cash flows. This protects against expected losses in performance of assets and is known as over collateralisation. The subordinated investors absorb the first losses in exchange of a higher return. Subordinated debts are generally unsecured by any assets and sponsors are to meet the interest payment when bondholders decide to exercise there put option extend often-higher coupon rates. This essentially is unsecured finance, which is senior to equity capital but junior to debt.

3.4.3 Escrow Accounts: An alternative to GOI guarantee is an escrow account agreement between lenders, project company and trustee bank. In this arrangement the inflows from the concerned project are pooled into a separate bank account by trustees and all debt servicing obligations are fulfilled before releasing the fund for further utilization. The use of escrow account is to allow the lender to control the proper use of project company’s cash flow. This policy acts as an assured flow of funds to lenders. All project company’s funds will be remitted directly to the escrow account. In India private sector power plants sell their power to SEBs preferably on escrow agreement. In Orissa, escrow agreements have been evolved between private power distribution companies, GRIDCO and power generating stations. But the limiting factor is that the agreement may create liquidity problem and reduce debt-bearing capacity of the issuing companies.
3.4.4. **Mezzanine Capital**: In infrastructure projects, the equity holders run a high risk as sometimes the projects under consideration would have no terminal value. On the other hand, adequate debt mobilisation is difficult due to limited appetite and inherent risks.

Mezzanine capital is particularly well suited for financing infrastructure projects, given the long gestation but generally stable cash flows after completion. For shareholders, it provides non-controlling capital and optimum financial leverage which helps to earn the target equity return. Sponsors can close the projects with higher debt than conventionally available. For senior creditors, it enhances debt coverage ratio and credit quality and amortization becomes faster. Mezzanine financiers themselves can have better return through interest, profit sharing and conversion.

Mezzanine capital would be available in four forms, i.e., subordinated debt, convertible debt, preferred equity and equity warrants. It is different from equity and senior debt in three ways: (a) order of claim (b) complementary and (c) spread. Its order of claim to cash flow and assets decides its risk profile between senior debt and equity. Its longer maturity and flexible repayment complement senior debt which have shorter maturity and straight line amortization.

Mezzanine capital can be availed from sponsors, contractors, multilateral infrastructure funds, institutional investors and even commercial banks. Some of the projects, which have benefited with mezzanine capital, are: Mindanao power in Philippines, Himal Power in Nepal, Hub power in Pakistan. In India, mezzanine capital is in vogue by way of convertible debentures issued by corporate.

However the financial structure of an infrastructure project depends upon:

- Various sources of fund (grants, soft loans, and equity)
- The role of financers (Development or commercial) and
3.5 Global Trends And Experiences:-

Global trends in infrastructure financing show some broad patterns and the experiences are quite illuminating. Infrastructure finance is growing rapidly since 1990s. There are wish lists, with commitments and closed deals. Even closed deals in developing countries show a quantum increase from $2641 mio in 1990 to $22,297 mio 1995. The private sector has outpaced the public sector, having raised almost twice as much in 1990s.

The distribution of funds raised is uneven across regions. East Asia leads, followed by Latin America whereas Middle East and sub-Saharan Africa trail. While infrastructure loans to developing countries in the last decades average $100 mn. with a maturity of under-10 years, Middle East and Africa have much smaller loans with shorter maturities. The sectoral distribution of external financing of infrastructure is dominated by power (44%), Telecom (30%) and transport (13%).

Finance flow is seen correlated with regulatory reforms, i.e., strongly reforming countries are getting more commitments. More countries and more sectors are now wooing infrastructure financiers and existing assets are also being opened for privatization and commercialization.

New players like insurance companies, Pension funds etc. are taking enclosure and more infrastructure funds are being set up both as equity
funds and mezzanine debt funds.\textsuperscript{5} (Here, two experiences are given in sharp contrast to each other.

International experience of IFC assisted projects: International experience of IFC assisted projects show a 3% cost under run and a 22% time over run in the implementations. It contrasts favorably with 17% cost over run and 60% time over run with the earlier projects assisted by the World Bank under public sector.\textsuperscript{6} Cost under run has been possible due to having fixed price contract and increasing competition among suppliers/contractors. Infrastructure projects show operating efficiencies and satisfactory financial performance across all sectors. Consumers have benefited by way of increased capacity, higher efficiency and wider choice. Tariff and operating cost have fallen substantially. Large amount effect of a few successful projects is catalyzing policy reforms and increasing flow of risk capital.

Private management and financing are seen generally offering better service quality and more innovative solutions than their official counterparts. Of course, these experiences of IFC are to be suitably qualified, because IFC assisted projects have survived rigorous entry test. Other infrastructure project may have a much higher mortality rate.

3.6. Domestic Experience In Project Implementation:-

In Indian context, many projects suffer due to government action, unclear regulatory responses, weak sponsors, inefficient linkages and unforeseen circumstances. These factors leads to delaying in financing/foreign credit/technology transfer, non-acquisition of land, inadequate feasibility study, shortage of funds (spreading plan funds too thin etc.). As per the annual report 1996-97, of the Department of Project Implementation of GOI 410 delayed projects suffered a cost over run of Rs.22771.4 crore, i.e. 22.7% on their latest
approved costs. Over run based on initial cost estimate would be much higher. It ranged from 62% (Guna-Etwah Railway.) to 2640% (Baghala-Chitani Railway.).

For financing of infrastructure both the lessons are illuminating. Under the same, socio-economic conditions, (IFC have 13.5% of total exposure in India), IFC assisted projects could have cost saving whereas Govt. implemented projects have large over runs. Sound financial packages and professional project managements practice makes the difference.

It was reported by J. Padmapriya "The total number of pending projects stands at 466 more than half of which dates back to pre ninth plan period. These projects having an average cost of Rs.285 crore suffer from cost over run of 32.1 percent. The costs have mounted from Rs.133269.9 crore to 175,984.7 crore according to data with the statistical ministry as on October 1, 2001.

The big laggard sectors include the railways, surface transport, coal and power. These sectors have a huge throw forward projects involving huge investments and cost overrun. The cases of the Railways are startling. It has 195 projects at present, which will be completed by standing Rs.39876 crore.

The railways are one sector for which unremunerative projects get announced every year in the Budget. This sector suffers particularly from this investment from investments spreads. While the overall cost over run in central sectors has declined considerably over the last three years, sectors like Railways, power and transport pulls down overall performance.

There is a massive cost over run of 51 percent in power sector with the original project cost of all the projects standing at Rs. 35724 crore. The
situation is similar in the case of surface transport, where costs have galloped ahead from Rs.6186 crore to Rs.9070 crore.

The sector that beats them all is health and family welfare. With just a couple of projects under its fold, this sector has allowed project costs to leap by 388 per cent, from Rs. 159 crore to Rs. 780 crore. But, some sectors do make up for the laggards. These include petroleum, telecom and mines, where investments come in on target and projects reflect zero cost overruns, the data revealed. And sectors that show less than 10 per cent overruns include steel, coal and civil aviation. Projects that were kicked off during the Ninth Plan number 226 and require investments of Rs. 87,099.45 crore. So far, an expenditure of Rs. 12,332.63 crore has been incurred.  

<table>
<thead>
<tr>
<th>Sector</th>
<th>No. of project</th>
<th>Cost</th>
<th>Revised cost</th>
<th>Over run</th>
</tr>
</thead>
<tbody>
<tr>
<td>Railway</td>
<td>195</td>
<td>27306.5</td>
<td>39876.3</td>
<td>46.0</td>
</tr>
<tr>
<td>Surface Transport</td>
<td>62</td>
<td>6186.0</td>
<td>9070.5</td>
<td>46.0</td>
</tr>
<tr>
<td>Coal</td>
<td>53</td>
<td>10159.9</td>
<td>11038.2</td>
<td>8.6</td>
</tr>
<tr>
<td>Power</td>
<td>36</td>
<td>35724.6</td>
<td>53878.0</td>
<td>50.8</td>
</tr>
<tr>
<td>Atomic energy</td>
<td>26</td>
<td>8708.1</td>
<td>12546.1</td>
<td>44.1</td>
</tr>
<tr>
<td>Total</td>
<td>466</td>
<td>133269.9</td>
<td>17584.7</td>
<td>32.1</td>
</tr>
</tbody>
</table>

Source – The Economic Times, 6th December, 2001
3.7. Projecting Infrastructure Investment: A Macro Estimate –

The infrastructure investment in 1980's and 90's - The total investment in infrastructure increased from about Rs.60 billion in 1980-81 to about Rs.290 billion in 1990-91 at the 94-95 prices and about Rs.500 billion in 1994-95. At constant 1980-81 prices the total infrastructure investment doubled over the decade. As a proportion of GNP, total investment in infrastructure ranged from about 4.5 per cent to 6 per cent. Average level of infrastructure investment in first half of 1980s was about 4.8 to 5 per cent of GDP. But after this there has been an increasing percentage of investment made in infrastructure sector, which became more than 6 per cent in 1990s. As a proportion of total gross domestic investment, GDI in infrastructure has varied between 20 to 25 in 1980s and 1990s.  

Rakesh Mohan committee is of view that the investment in infrastructure must grow up to 8 per cent of GDP by 2005-06. Thus, it would continue to comprise 22 to 25 per cent of gross domestic investment. In absolutes term the investment in infrastructure will be Rs.1800 billion rupees in the year 2005-06. Further it would be Rs.7400 billion in the following years from 2001-2002 to 2005-06.

According to sectoral projections the investment in power will be about Rs.809 billion in the year 2005-06, urban infrastructure will be around Rs.600 billion.

Growth scenario:- The Tenth five-year Plan (2002-2007) is being up in the backdrop of many strong points of economic performance. GDP growth in the post reforms period has improved from an average of 5.7% in the 1980s to an average of about 6.5% in the Eighth and Ninth Plan periods, making India one of the ten fastest growing developing countries. It is proposed to have an indicative
target of 8% during 2002-07. The growth has to be induced substantially by increase in efficiency of resource utilization in addition to increased investment. The scope for realising this efficiency is very large both in the public sector and the private sector.

The industrial sector will have to grow at over 10% to achieve 8% GDP growth. This will place heavy demand on the infrastructure, especially generation and distribution of electric power. Not only availability of electricity but also its quality and reliability will be critical for the competitiveness of the Indian industry in the increasingly integrated international economy. The performance of the NTPC and other state utilities in implementing the various reform initiatives will, in turn, be critical to effective performance of the power sector. Thus, a reformed power sector is the key to our country's economical progress.

Infrastructure investment is not easy to estimate. Different countries have developed elaborate system in order to co-ordinate infrastructure investment and the growth of economy. But it must be kept in the mind that public sector investment in infrastructure is often supply oriented. Thus the estimation may be bias. Again with the introduction of private sector and overall commercializing the demand for infrastructure is likely to be price sensitive.

However in an article by Pratip Kar on the amount of investment in infrastructure sector in India, has projected "The India infrastructure report prepared by an expert group on commercialization of infrastructure projects set up by GOI, had projected the investment requirement for capacity expansion in four infrastructure sector, viz. power generation, telecommunication, ports, roads over a ten year period 1996-97 to 2006-07 was estimated to a range between Rs.325000 crore to Rs.394000 crore at 1996-97 price to support and accelerate economic growth to 7.5 per cent by 2002 and 8.5 per cent by 2006."
In another article "Private investment in infrastructure" B. K. Modi, stressing on the need of private infrastructure said "India's infrastructure investment requirement stand at US $ 115-130 Billion in the following five years. (2001 to 2006) Undoubtedly, in the current fiscal situation, the government can't alone mobilise such huge sums, even with market borrowing to provide budgetary allocation to departments or Public Sector Enterprises engaged in infrastructure development.

It is evident that if we are to develop our infrastructure rapidly and effectively, a majority of funding has to flow in form of private capital". Estimating the need of investment in infrastructure sector is a complex affair. All related parameters, i.e., economic growth, balance of payment, gross domestic product, gross domestic savings and investment, quantum of infrastructure capacity to be created need to be examined.

Dr. APJ Abdul Kalam in his book “INDIA 2020” has indicated the amount of investment as, "The aggregate level of investment in infrastructure increased from about Rs. 6000 crore in 1980-81 to about Rs.29000 crore in 1990-91 and to about Rs. 50000 crore in 1994-95. As a proportion of GDP, the investments in infrastructure ranged from about 4.5 per cent to 6 per cent. Of the total annual investments in the country about 25 per cent are in infrastructure projects. It is estimated that investments in infrastructure during 1997-2002 may be about Rs.500000 crore and about Rs. 750000 crore during the next five years.

Figures of this magnitude may seem intimidating but the truth is that for all the inefficiencies of administration, and even one might say, a certain lack of commitment to make this a great nation

The share of the railways has been only about 0.6 per cent of the GDP and has remained stagnant over decades. There is a great need to
increase it because railways are an extremely energy efficient mode of communication. Of late the number of railway accidents is increasing and it also appears that most line expansion projects are moving very slowly. There are a number of technologies for high-speed trains, which are possible and have been talked of at various forums. It is essential to modernise many parts of our railway tracks, signaling system and even facilities for passenger comforts. For the movement of goods, it is possible to have multimode containers, that is, containers which are standard for railways, roads, ships or aircraft. Investments in road transport and waterways have ranged between 1.3 to 1.6 per cent of GDP, investment in electricity has been on the average about 2.5 per cent to 0.8 per cent of GDP.

One way is to increase GDP, but without improving infrastructure GDP cannot grow! Without investments, roads or electric power or telecommunications or ports cannot come up. Not really. There are many private investors in India and abroad who would be ready to investigate projects, which would yield returns over a long period. It is necessary to attract them to invest in these projects. Since 1991, the government has been granting several concessions to attract them. But much of this investment has come in bits and pieces. Some of these investors had unrealistic assumptions. Nevertheless, private investors do seek profit. It is necessary to assure them of reasonable profits and to give them cover for certain risks. The government has to ensure that the long-term interests of the country or the public are not unduly compromised. Considering the fact that the development of infrastructure is integral to speedy economic growth – the only way our people can break out of centuries of poverty – the country has to learn to be innovative in offering packages, which will attract investments.
Investors complain that the path to investment is riddled with time-consuming procedures. The only way to put in place attractive policies and make them work is to simplify procedures. The authors are not unaware of the various vested interests that have been built up over time. Many in India believe that from the lowermost counter, which gives out important application forms which the government requires to be filled, to the highest levels there are a large number of avenues to convert 'authority' into money. We believe a call for a new vision for India with a higher aim and sincerity, resulting in jobs for almost everyone, and with the makings of a movement, would remove many of the present cobwebs. In pre-independence India, Indians were after all only viewed as fighting with each other over caste, religion, language and more. Did the people not join a great movement without any guns or arms to dislodge a mighty empire?

Coming back again to the investment question, even while private sector investment will be essential to build up infrastructure, the government has to invest too. Estimates indicate that the funds required to improve the existing national highways as well as to expand them would be about Rs. 150000 crore. The private sector could contribute a proportion, but the remainder will have to come from the government (both central and the states). But here we need to question whether most of the funds indicated are really required. Some assumptions need to be re-examined: "should widening of an existing road form single lane to double lane cost about Rs.50 lakh per km? And is the same amount again needed for improving the double lane pavements of existing roads? Should the cost of widening double lanes to four be about Rs.250 lakh per km? Should a new expressway cost Rs. 800 lakh per kilometer? We are not questioning the capability of our engineers and accountants. Such estimates are worked out since nobody wants to be accused of not using materials of a particular standard, even when this is not exactly relevant. Therefore a lot of 'padding' has been built into the system over the years." 13
3.8. A look into the Public Finance of GOI-

The public sector has been the dominant investor in infrastructure over the last 50 years. During the 1980s, when total infrastructure investment ranged from about 4.5 per cent to 5.5 per cent of the GDP, public sector investment ranged from about 3.5 per cent to 4.3 per cent. Private sector infrastructure investment has generally been in the 1.13 per cent range as a proportion of GDP. At present, most of private sector share in infrastructure is the "other transport" sector, which consists mainly of the road cargo transport industry - almost fully in the private sector and road passenger transport - shared in the public and private sectors.

The public sector supplied more than 90 per cent of investment in power, water supply and sanitation, railways, roads, telecommunications etc. The private sector is only a marginal player in each of these areas at present. Currently, private sector participation is being actively pursued in the provision of power, telecommunication and for a segment of roads. Discussion has begun on private participation in urban infrastructure provision, but arrangements enabling such participation are still in the made.

Indian Infrastructure Report,(IRR) 1996, projected share of the private sector to increase from the current 25 per cent to 40 per cent by 2000-01 and to about 45 per cent by 2005-06.A projection in IIR has been made which hopes that about 44.2 per cent of investment shall be made by private sector by the year 2002-06.14 So a circumstance needs to be created by government. So as there shall be mobilization of fund from private sector.

3.9. Infrastructure Development Finance Company (IDFC):- As per recommendation of Rakesh Mohan committee to create an apex institution to
handle to infrastructure project, infrastructure development Finance Corporation was incorporated in the year 1998 as a non-banking financial company.

3.9.1. The Mission and Objectives of IDFC - The Mission And Objectives Of IDFC is to help create the policy framework for investments in India's key infrastructure sectors and develop a range of innovative financial instrument. It will also concentrate on credit enhancement mechanisms, lengthening maturities, providing mezzanine finance and help develop long-term debt markets in the country and also shall take of.

3.9.2. Liquidity and Maturity Management: - These include take-out finance, refinace of other financial institutions, stand-by finance and liquidity support to market makers, fee based services like loan syndication, partial credit guarantees and fund management and equity investments and subordinated loans/mezzanine finance. In fact, many of these products will be introduced in India for the first time.

3.9.3. IDFC Source of Funds- It has a total capitalisation of Rs. 1650 crore out of which debt amounts to Rs. 650 crore GOI, RBI and IDBI holds 40 per cent foreign lenders CADB, AIG, Singapore government holds 40 per cent and HDFC, ICICI, IFCI, SBI and UTI holds 20 per cent each and has also raised Rs. 650 billion. In the domestic market it shall resort to structured debt issue which will actually be a private placement to banks, insurance and provident funds. In addition, IDFC plans to approach international credit rating agency, to get a rating equal to the sovereign ceiling to set in place the discipline of sound risk management practices from an early stage of its operation. This will also position IDFC to access international debt markets should it need to do so in future.
3.9.4. Infrastructure Funding: The key activities of IDFC will be to provide underwriting facilities, refinance facilities, take-out finance and liquidity support to market makers. The institution would also extend loan syndication, partial credit guarantees and fund-management as part of its fee-based activities. In addition, IDFC will also focus on providing inputs for policy reforms to mitigate constraints faced by infrastructure projects besides extending financial intermediation for such projects. IDFC sees a major role for its advisory services segment in the initial years, as much of the problems associated with the infrastructure finance in India originates from structural risks arising out of institutional, legal and policy related issues.

The IDFC, which has so far sanctioned Rs.100 crore of loans for infrastructure projects, is also talking to the World Bank, global insurance companies and the Union Government for some "back up support". The company, however, provides very little of direct loans to infrastructure projects and concentrates mostly on "credit risks and liquidity support" for finance. To quote their Chairman, Mr. Deepak Parekh, "We are using the surplus liquidity of the banks to lend at a higher rate". The credit risks and liquidity supports to the banks are offered in the form of credit enhancements, guarantees and innovative products like "take-outs" for infrastructure development projects.

The IDFC has, for a start, signed a memorandum of understanding (MOU) with the SBI for Rs.300 crore of "take-out" financing the five-year commitment from IDFC will ensure "liquidity support" to SBI and companies availing of these assured funds will pay a 0.5 per cent fee to IDFC. Bharati Telecom has already availed of Rs.25 crore of take-out financing. The IDFC is also doing a take-out for some banks in South India, which are funding the Videocon Power Project. The idea of the take-out financing arrangement is to facilitate preparation of a "bankable concessional agreement". IDFC has already
launched its maiden product, take-put loan, by signing an agreement with State Bank of India. Simply put, the take out product will guarantee banks/financial institutions to pick up their loans to infrastructure projects after an agreed time frame. This is mainly to facilitate banks with even short or medium-term perspective to participate in the funding of infrastructure projects with a risk profile that suits their appetite with an implicit guarantee from IDFC, which overcomes the problem of maturity mismatch. IDFC has drawn up plans to launch two more products in the nature of sub-debt and mezzanine finance for the infrastructure sector.

IDFC has already committed Rs. 900-1000 crore (both fund and non-fund based) for none projects - four in power sector, three road schemes and two bridges. IDFC has also staked a claim for the RIB (Resurgent India Bonds) funds raised by the SBI from non-resident Indians. Additionally, the Ministry of Surface Transport had commissioned IDFC's services to 'map out' the procedures for privatization of Enron Port. The assignment would cover the entire gamut of issues involved in port privatization. The fee-based job mandates IDFC to go into the bidding process in its entirety and help prepare bidding documents and lay down norms for their evaluation. As part of this process, IDFC will take a close look at 'concession' 'agreement' and advise on the most efficient way of allocating risks. The Ministry of Surface Transport assignment also calls upon IDFC to suggest an appropriate process map for corporatising the Enron Port. Since the government failed to address the lenders concern while drawing up the concession agreement, IDFC would be taking the lenders concern too, into account while preparing the model bidding document for the Enron Port privatisation project.

3.9.5.Recent Initiative at IDFC: - IDFC will shortly be placed on par with the other public financial institutions, with the necessary amendments to the
Companies Act regarding this. The classification of IDFC as a public financial institution will help the newly formed infrastructure finance provider access to long-term funds from pension funds and insurance companies like a host of other financial institutions. It will also make the company eligible for several other benefits, which all the major Indian financial institutions enjoy now.

A public financial institution is defined as an entity in which the Central or the State Governments have a controlling stake of 51 per cent or those, which are formed under a statute. In the later category are the Unit Trust of India and the Industrial Development Bank of India. IDFC could not be included in this list of public financial institutions earlier as it was neither an organisation where the Government was a majority shareholder nor was it set up through an Act of Parliament. IDFC has been incorporated as a non-Government company under the Companies Act 1956.

The choice before the Government, therefore, was to notify IDFC also as a public financial institution or to amend the Provident Funds Act to enable the institution to tap the pension funds for raising long-term money, officials said. This is expected to be done when IDFC issues long-dated bonds to finance infrastructure projects.

While the setting up of IDFC is definitely a step in the right direction, the small capital base of the institution leaves a lot of questions unanswered. With a small capital base, there is little contribution that IDFC can make in the fund-based financing of infrastructure. Considering the huge fund requirements in the power, telecom and transportation sector, the fund base of IDFC is too minuscule to make any impact. Even in the area of quasi-fund based and fee-based activities automatically call for a long-term nature of IDFC's assets, virtually shutting the short-term money market as a source of raising
funds. A single IDFC can do little to improve the state of infrastructure in India. What the current situation calls for is many more IDFC or a substantial support from the government both in the form of funds and guarantees to the infrastructure sector.

3.10 Recommendation:

After consultation with different experts and findings from different journals, we put forward following recommendations in order to face successfully the emerging challenges in infrastructure sector.

- Equity investment in long gestation infrastructure projects should have tax relief like the erstwhile 80CC provision in order to attract capital in the construction and pre-operative phases. Also dividend payable on equity investments in infrastructure should be made cumulative for payment of dividend for the entire period until the project goes on stream up to reasonable level on the equity investment.

- The debt equity norms for funding infrastructure will have to treat the compulsorily and fully convertible debentures as quasi-equity and such debentures could be subordinated both for principal and interest to all secured and unsecured creditors of the project. The projects could have nominal ordinary equity capital and large measure of cumulative preference share (CPS) with the provision that at the end of a specified period (say 10th years) the CPS will be compulsorily converted into equity shares through a pre-determined pricing formula.

- Insurance, Provident And Pension Funds - As recommended by the Malhotra Committee on Insurance Sector Reforms, General Insurance Company and its four subsidiaries can be split up into small entities to increase competition in the insurance companies, both domestic and foreign companies should be allowed and encouraged to enter as soon as
possible This is essential for developing the debt market for infrastructure requirements.

➢ The Employee's Provident Fund (EPF) could be split up and managed by professional asset management companies on a competitive basis. Such a measure would usher in great competition in the provident fund business and provide incentives to those institutions to invest and trade in debt management more actively. Further, in order to motivate provident fund managers, a performance based incentive structure may be introduced, as is the case in developed insurance markets. Arrangement should be made under a suitable regulatory framework, to allow the establishment of new private (and public) provident and pension funds. These would provide added avenues for safe contractual savings for even those outside the organised sector.

➢ Current guidelines for deployment of funds by insurance companies, provident and pension funds are not flexible enough from the point of view of efficient fund management and to yield maximum return. The existing guidelines could be replaced with guidelines based on prudential norms, which permit investment in securities with minimum specified credit range. Prudential guidelines as in the case of mutual funds, specifying maximum limits will have to be devised for this purpose. The existing guidelines have directed the flow of funds into specific sectors, instead of controlling the interest rates and credit risks to which these institutions are exposed. It may be appropriate to modify the guidelines so as to eliminate/ minimise this form of "directed credit" and increase the responsibility of the investment managers. Market and credit risk restrictions may need to be enforced as insurance companies, provident and pension funds have extremely long maturity liabilities. We also recommend that the guidelines be modified so as to provide greater operational flexibility to fund managers.
The process of granting approvals by the Ministry of Finance (MoF) and the RBI for all aspects of external commercial financing may need streamlining. Arbitrary ceiling put on the "spread" over US Treasury yields for foreign currency debt financing or the shortening maturities as specified in the guidelines on External Commercial Borrowing [ECB] make it difficult for foreign investors to finance projects.

If Indian corporate and financing institutions are to tap the global capital makers periodically for mobilising resources, it may be best in the India's interest to consider a sovereign offering which will serve as the bell whether for future issuance. The establishment of "benchmark" issue will be important for the development of India's access to the capital markets. Much of the investors use the US Treasury as a benchmark to determine valuation of other issues, foreign investors would prefer a sovereign security, which could serve as the benchmark for valuation of Indian paper.

At present there is no special channel for such funds to invest into infrastructure products in India except for going through the FIPB like any other foreign investment. It would be very desirable to place investments from such funds on a preferred footing. They could be treated in a manner similar to the investments made in the capital market by FIIIs at present. FIIIs have to register with SEBI consequent to which they are permitted to invest in listed companies. A similar channel could be opened for infrastructure funds. They could be registered with SEBI based on transparent guidelines related to their recognition. They could then be allowed to invest in eligible infrastructure projects.

A considerably higher measure of investible resources is required in order to achieve the industrial growth rate target of 10 per cent per annum. The augmentation of the resource base requires action on several fronts. To begin with, the bleeding of the resources base in the form of unproductive
public sector undertaking (PSUs) enterprise is to be checked on a top priority. All road locks to this process be removed.

- Simultaneously, vast resources are intended to be released from areas of low productivity in the public sector. This requires disinvestments of PSUs so that our resources are released and transferred to more efficient management. Taking into account the slow pace of disinvestments, the issue of management of the public sector in the transition period is also being given focused attention.

- The subsidy burden also needs to be drastically reduced. At present the subsidy in fertiliser sector and the public distribution system together account for over Rs.20000 crore. It is important that PDS should only serve people below poverty line. The problem of subsidy must be tackled through bold steps and efficient pricing policy.

### 3.11. Conclusion:

In order to mobilise additional resources, the policy makers need to evolve a healthy Indian capital and financial market to tap the vast savings potential of the Indian household sector and transfer it to industry through efficient financial intermediaries. Restoration of investor confidence is an absolute necessity for augmenting the resource base. The recent financial sector scandals point to the need for utmost caution on the part of the regulatory institutions, which have been set up. Corporate governance cannot be improved unless creditable and transparent rules of conduct are evolved and enforced by industry associations. Serious attention must be given to issue of foreign investment (both portfolio investment and foreign direct investment). FDI is an additional source of funds but the technology it brings in with itself and the market access it provides, have vast implications for productivity and quality.
References:


2. ibid ,11 pp

3. "Mezzanine Finance: Closing the gap between debt and equity" ,ICFAI Reader,(feb.03,2003). 54 pp


6. ibid, 88 pp


10. Ibid. 12 pp.

12. Modi, Bhupendra Kumar, "Private investment in infrastructure". The Economic Times (July 17th, 2000.)


14. The India Infrastructure Report, op. cit, 88 pp

15. Ghose, Sujata. "IDFC takes a breather" The Economic Times (June 8, 2001) 1

16. Ibid. 3.