Chapter V

INFRASTRUCTURE FINANCE

AND

INSURANCE

IN INDIA

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INTRODUCTION:

The development of an economy depends directly upon the availability of financial infrastructure facilities such as banking, insurance, etc. Banks facilitate in promoting the rate of savings and thereby help spending up the rate of capital formation. Different states are having the different levels of financial infrastructure which help in their economic development to a great extent.

Infrastructure projects are capital intensive and have long gestation periods. They face risks during pre-construction, construction and post-construction stages. The level of risk falls as the project matures. Therefore, factors such as strength and experience of promoters, clarity on government policies, tie-up arrangements, contractual framework, tax benefits, projects structuring, etc., play crucial roles. Infrastructure projects are financed through non-recourse or limited recourse funding. There are many ways in which institutional investors, Indian or foreign, can invest in infrastructure. The participation can be direct or indirect, in equity or in debt, in the primary or secondary markets. The debt is financed mainly by Development Financial Institutions (DFIs), Multilateral Agencies, Domestic and Foreign Commercial Banks and Export Credit Agencies (ECAs). These agencies provide debt themselves and also help arrange loans from other sources. They also provide guarantees and play an advisory role. The key domestic financial institutions include the Industrial Finance Corporation of India, Industrial Development Bank of India, Life Insurance Corporation and Small Industries Development Bank of India. There are also niche institutions including the Infrastructure Development
Finance Company; The Power Finance Corporation and Rural Electrification Corporation for Power; and The Housing Development Finance Corporation for the Housing Sector. In India, the World Bank and the Asian Development Bank have been the most active in lending to infrastructure projects. The International Finance Corporation and The Japan bank for International Cooperation also provides loans to infrastructure projects. Banks are also increasing exposure in infrastructure. Prominent lenders include the State Bank of India and its associate banks, ICICI Bank, Punjab National Bank, Canara Bank, Bank of India, Union Bank of India, Allahabad bank, Oriental Bank of Commerce, Corporation Bank and Syndicate Bank.

FINANCING TRENDS:

Opportunities are increasing by the day as more projects are conceived, developed and commissioned. The options are also becoming more complicated as financing structures evolve. According to planning commission estimate, India needs investment of about $492 billion (until the end of 2011-12) for its infrastructure requirements and close to $145 billion of that will have to come in from private investors. The reform and liberalization process has, to a great extent, been dictated by the need to attract that investment and indeed, Infrastructure has emerged as an attractive asset class for both Indian and Foreign investors.

Some of the key trends in infrastructure finance are –
Capital Markets and Initial Public Offers:

Ability of infrastructure companies to tap the equity markets to fund capital requirement has been observed as the most significant trends. Equity is a superior financing root in the Indian context since secondary equity market are much better developed than debt market, offering greater liquidity. It is estimated that during 2006-07, about 20 infrastructure companies tapped capital markets and raised about Rs168.54 billion through Initial Public Offers (IPOs). This marked an increase of 230 per cent over the amount raised by 16 infrastructure companies in 2005-06.

Public Private Partnerships (PPPs):

Another most significant trend has been the emergence of public-private partnerships (PPPs) as a viable source of project funding. PPPs allow for better risk allocation, faster implementation, reduced costs, improved quality of service and enhanced public management. Sector-wise PPPs in India have mostly been prevalent in the transportation sector. According to finance ministry, since August 2006, 29 projects worth Rs 180.29 billion have been given final approval under the PPP route. While 23 of these projects are in the roads sectors, six are in the ports and shipping sector. The aviation sector is also witnessing increased PPP activity. At present, four airport projects – Delhi and Mumbai modernization projects and Bangalore and Hyderabad Greenfield airport projects – are being implemented on PPP basis.
Infrastructure Funds:

The opportunities in the infrastructure segment have led many domestic and foreign institutions to set up infrastructure funds. These funds typically provide equity and debt financing with exposure at the corporate level or at the projects level. India Infrastructure Finance Initiative (IIFI) was created by Citigroup, Blackstone, Infrastructure Development Finance Company (IDFC) and India Infrastructure Finance Company Limited (IIFCL) with a corpus of $5 billion. The fund will deploy $2 billion in equity and $3 billion in long-term debt financing, with maturities exceeding 10 years. Funds on the lines of IIFI have been launched by the State Bank of India with a corpus of $1 billion. IDBI Limited and the Life Insurance Corporation have also formed a strategic alliance to fund infrastructure projects through joint and take-out financing for long gestation projects. The government also announced the India Infrastructure Project Development Fund (IIPDF) in the 2007-08 budget. The fund has an initial corpus of Rs1 billion. IIPDF will finance up to 75 per cent of project development cost as interest-free loan to be recovered from the successful bidder with "return". With the growing opportunity in the infrastructure sector, a number of theme-based mutual funds that invest in infrastructure companies are also coming up.

Bank Credit:

After the relaxation in norms by the RBI banks are also increasing their exposure in infrastructure. During financial year 2006-07, commercial banks' outstanding exposure to the infrastructure sector was Rs 1,429.75 billion. Of this, the power
sector accounted for the majority of the shares at 50.9%, followed by roads and forts at 17.4% and telecom at 13.6%. Commercial banks' outstanding credit to the infrastructure sector has grown at a compounded annual rate of 35.3 per cent since 1999. The trend of funding projects through a consortium of banks has also become prevalent as it results in the sharing of risks. However, commercial banks continue to be plagued by issues of asset-liability mismatch, sector-wise caps and prudential limits that hobble exposure to infrastructure. External Commercial Borrowings (ECBs) are also an important source of infrastructure finance. It is estimated that in 2006-07, Rs 176.35 billion was raised by the corporate sector for infrastructure projects through ECBs. However, the RBI has imposed more restrictions on foreign funds flows for rupee expenditure and interest rates have risen due to the U.S sub-prime crisis.

**Bonds and Pension Funds:**

Apart from equity and bank credit, bonds are sources of infrastructure finance. In India, bonds are issued by way of government borrowings and through private placement and the issue of commercial paper. According to industry sources, about Rs 2,319.5 billion was raised through bond issues during 2006-07. Of this, government borrowing accounted for 65 per cent, private placements for about 39 per cent and the rest was constituted by commercial paper. Over the years, private placement has become increasingly popular. Figures indicate that while the share of private placement increased by almost 42 per cent from 2004-05 to 2005-06, the share of government borrowings increased by about 36 per cent.
The share of corporate debt or commercial paper has been quite low. Pension and insurance funds are slowly gaining ground but are yet to become popular as insurance companies are often not able to invest due to rating constraint. Public sector companies National Highways Authority of India (NHAI) and Rural Electrification Corporation (REC) are allowed to issue tax-free bonds, in the year 2006-07, the NHAI issued bonds worth Rs 35 billion. REC also received government approval to issue bonds worth Rs 35 billion to fund the supply of power to villages in the next three years. However, a lot needs to be done to develop the corporate bond markets and channelise pension funds into long-term infrastructure projects.

MAJOR PLAYERS OF INFRASTRUCTURE FINANCING:
Infrastructure financing has largely been the domain of government funding and multilateral institutions such as the Asian Development Bank (ADB) and the World Bank. With reforms leading to acceleration in the pace of infrastructure development, more players are now offering low-cost funds with high maturity profiles. The growing popularity of universal banking and relaxations in norms by the Reserve Bank of India has encouraged commercial banks to take significant exposures in infrastructure. The lending of commercial banks to infrastructure has grown at a compounded annual rate of 35.3 per cent since 1999 and reached 1,429.75 billion as on March 2007.

The list of prominent financiers now include the Infrastructure Development Finance Company (IDFC), Industrial Development Bank of India (IDBI), Industrial
Finance Corporation of India (IFCI), State Bank of India (SBI) and Life Insurance Corporation (LIC). Apart from these, sector-specific institutions such as the Power Finance Corporation and Hudco and other financial institutions like SIDBI and IL & FS have also become more aggressive.

Commercial banks such as Punjab National Banks, United Bank of India, Canara Bank, Oriental Bank of Commerce, Bank of Baroda, Bank of India, Corporation Bank, Syndicate Bank, Dena Bank, Indian Bank, Indian overseas Bank, Union Bank of India, Central Bank of India and Allahabad Bank have also increased exposures to infrastructure. Several foreign banks have also entered the arena.

The key players of infrastructure financing and insurance are –

WORLD BANK

The World Bank is the largest multilateral funding agency in India. It provides low-cost, long-tenor financing to infrastructure projects through loans under its International Development Assistance and International Board for Reconstruction and Development policies. The Bank also provides technical assistance for undertaking feasibility studies of projects.

As of June 30, 2007 there were 67 active World Bank projects in India with total commitments of about $14.3 billion. In financial year 2006-07 (July-June), the Bank made new commitments to the tune of $3.7 billion. This marked an increase of 164.28 per cent over commitments in 2005-06.

The world Bank is a major investor in the transportation sector of India. At present, the Bank's total commitments for the transport sector are $4.95 billion. It
has provided 17 loans for improvement of national highways and state highways and 18 loans for railways.

The multilateral agency has also begun to focus on energy. Recent data released by the Bank indicate that out of the total lending of $729 million since June 2007, the share of the energy sector was the highest at 63 per cent.

Recently, the World Bank supported the restructuring of West Bengal's state electricity board by providing a soft loan of Rs 70 million and approved $400 million loan to Satluj Jal Vidyut Nigam Limited for the 412 MW run-of-the-river Rampur hydro projects in Himachal Pradesh. It is also supporting the expansion program of Power Grid Corporation of India Limited and has sanctioned loans for several road projects in Himachal Pradesh, Orissa and Tamil Nadu during 2007.

The Bank's private equity arm, the International Finance Corporation, also had a portfolio of over $2,117 million (June 30, 2007), which was an increase of 68 per cent over the previous year.

ASIAN DEVELOPMENT BANK (ADB)
ADB has also been an active player in infrastructure financing. The multilateral agency has been providing support to India in the form of policy dialogue, loans, technical assistance, grants, guarantees and equity investments.

At the end of December 2006, ADB had extended loans worth $10,606.2 million towards infrastructure projects constituting about 64.5 per cent of ADB's lending to India. Of the total loans extending to infrastructure, 29 loans were to the energy sector aggregating $5,125.8 million, 24 loans to the transportation and
communication sector aggregating $4,979.2 million and 3 loans aggregating $501.2 million for water supply and sanitation projects.

ADB provided a loan of $75 million to NTPC to fund the Sipat super thermal plant in Chattisgarh and the Kahalgaon super thermal plant in Bihar and approved a loan of $620 million for the Madhya Pradesh power sector in April 2007. It also provided a $320 million loan and $1 million technical assistance grant to the Madhya Pradesh government to improve the state road network and has also funded the expansion program of Petronet LNG Limited. The multilateral agency is also planning to fund the 4000 MW Mundra Ultra Megha Power project being developed by Tata Power Company (TPC).

**INFRASTRUCTURE DEVELOPMENT FINANCE COMPANY (IDFC)**

IDFC was incorporated on January 30, 1997 as a specialized institution to facilitate flow of private finance to commercially viable infrastructure projects. It provides assistance by way of debt and equity support, mezzanine structures and advisory services.

As on March 31, 2007, IDFC's exposure to infrastructure projects was Rs 220.4 billion. Of this, the energy sector accounted for the highest share at 39 per cent, followed by transportation at 27 per cent, telecom and information technology at 17 per cent, industrial and commercial at 14 per cent and others at 3 per cent.

During 2006-07, IDFC approved loans worth Rs 130.53 billion for various infrastructure projects, of which around 55.2 per cent was disbursed. Of the outstanding disbursements, 2.5 per cent was as equity while a major share (92
per cent) was as loans. IDFC has set up the India Development Fund with an initial corpus of Rs 10 billion. The fund invests in the equity of infrastructure projects.

Recently, it has launched $5 billion initiatives in association with Citigroup, Blackstone and IIFCL for financing infrastructure projects in India. Of this $2 billion will be deployed as equity capital, while the remaining $3 billion will be raised through long-term debt with maturities exceeding 10 years. IDFC has initially invested $25 million in equity for the fund.

ICICI BANK

ICICI is the largest Indian private sector bank. As on March 31, 2007 it had loans and advances of Rs 1,981.9 billion. Of this, about 7.1 per cent was in various infrastructure sectors. However, the share of the infrastructure sector declined as a percentage of total advances from 12.32 per cent in 2005 to 7.14 per cent in 2007.

In 2007, the exposure to the power sector was 2.1 per cent of total advances as compared to 1.8 per cent in 2006. As on March 31, 2007, the total advances to crude petroleum/refining and petrochemicals were Rs 48.57 billion, power Rs 41.28 billion, roads, ports, telecom and urban infrastructure Rs 29.87 billion and electronic and engineering Rs 21.86 billion.

Some of the projects financed by ICICI bank during 2007 include Raj West Power Limited, where the bank syndicated Rs 36.75 billion as a lead banker of a consortium. It also led the financial closure of the Teesta VI hydro project and
was appointed lead arranger for Delhi International Airport Limited. It was also part of the consortium that funded the UB Group’s acquisition of 46 per cent stake in Deccan Aviation.

The bank is in the process of setting up a $2 billion infrastructure fund.

INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)

IDBI is amongst the largest commercial bank in India. In July 2004, it received board approval for conversion into a bank, which gave it greater operational flexibility and lower funding costs. IDBI provides project finance in both rupee and foreign currencies for green field projects, as also for expansion, diversification and modernization.

Most of IDBI’s advances are for the power and telecom sectors. As on June 30, 2007, IDBI’s exposure to power generation was 8.14 per cent followed by telecom as 5.8 per cent as a percentage of total industry exposure. Apart from these, it also lends to other infrastructure sectors including airports, ports and highways.

IDBI has participated in financial closure for a number of projects. Its recent power projects include the 1,015 MW Nagarjuna project where IDBI contributed Rs 880 million, the 1000MW Raj West power project and the 330 MW ShriNagar hydro power project. It also syndicated debt for the 1,200 MW Rosa project for around Rs 20 billion.

IDBI also led the consortium for financing of Mumbai International Airport Limited and Dhamra Port Company Limited. It also syndicated debt of Rs 30 billion for
Idea Cellular Limited and led the consortium for financing Kundli-Manesar-Palwal Expressway Limited, a special purpose vehicle executing the Rs 19.15 billion Kundli-Manesar-Palwal expressway limited.

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

IFCI is amongst several financial institutions set up to promote development in India. Infrastructure is the largest recipient of IFCI's largesse.

As on March 31, 2007, IFCI's net outstanding in the infrastructure sector amounted to Rs 14.02 billion. This accounted for 16.1 per cent of IFCI's total outstanding.

IFCI's net outstanding to the infrastructure sector, however, declined from Rs 16.82 billion in March 2006 to Rs 14.02 billion in March 2007. This is in line with its strategy to avoid fresh commitments and monitor its portfolio stringently.

Sector-wise, power accounts for almost 66 per cent of the net outstanding. The rest is divided between the port, telecom and other infrastructure sectors. Some of the projects financed by IFCI in the past include the 355 MW Lanco Kundapalli project in Andra Pradesh and the 655 MW Gujrat Paguthan Energy project. It has also lent to Adani port in Gujrat and the Noida Toll Bridge project.

Currently, IFCI in the process of selling a 26 per cent strategic stake for which it has invited expressions of interest for different investors. Such a move is likely to instill confidence in the institution.
STATE BANK OF INDIA (SBI)

SBI set up a specialized unit called the Project Finance Strategic Business Unit (PFSBU) in 1995 to deal with infrastructure lending. PFSBU handles projects with a project cost of over Rs 1 billion. Their proposed share of SBI in the term loan is required to be more than 500 million and in the case of road sector projects, the cut-offs are Rs 500 million for project cost and Rs 250 million for SBI's term loan.

During 2005-06, PFSBU extended sanctions to 18 projects worth over Rs 40 billion. This is significantly higher than its 2004-05 exposure, when the unit sanctioned 13 projects at costs exceeding Rs 25 billion. Apart from the sanctions, the unit also arranged or tied up Rs 70 billion of debt either by itself, or in conjunction with its associate banks.

Since 2006, SBI has provided a loan of Rs 17 billion to the Damodar Valley Corporation to fund its expansion program. It also led the financial closure of JSW Energy's 1,200 MW coal-based power project at Ratnagiri. It also participated in refinancing a $950 million bridge loan facility taken by TPC to acquire 30 per cent stake in Indonesia's PT Kaltim Prima Coal and PT Arutmin. The bank also lend $25 million to Great Eastern Energy Corporation Limited and funded the expansion program of Air India, Mundra Port and Special Economic Zone Limited, Suzion Energy, Petronet LNG and Gujrat State Petroleum Corporation.

In the future, SBI is looking to set up a $1 billion infrastructure fund, which will invest in both domestic and overseas markets.
INDIA INFRASTRUCTURE FINANCE COMPANY LIMITED (IIFCL)

IIFCL was formed in January 2006 as a hundred per cent government-owned infrastructure financing SPV. The SPV funds infrastructure projects for up to 20 per cent of the total project cost.

IIFCL funds commercially viable projects through long-term debt, refinancing banks and financial institutions for loans of tenor longer than 10 years, or of any other form permitted by the union government. Its tenors normally extend up to 10 years.

The company has entered into strategic partnership with 3i Group of the UK, IDFC, IL&FS and 18 other banks and financial institutions to facilitate equity and debt support for infrastructure projects. IIFCL has also set up a debt fund of $3 billion. Further, IIFCA has set up an equity fund of $2 million with IDFC, Citigroup and Blackstone, where it has contributed $25 million.

Cumulatively, till November 30, 2007, IIFCL has approved financial assistance of Rs 163.81 billion to 71 infrastructure projects at an investment of Rs 1,97.90 billion. The highest number of loans were sanctioned for the power sector at Rs 197.37 billion, followed by roads and airports at Rs 41.80 billion and Rs 21.50 billion respectively.

IIFCL also proposes to set up an overseas subsidiary in London or Singapore to utilize forex reserves for financing infrastructure projects.

During 2007-08, IIFCL expects to sanction loans worth Rs 150 billion to the infrastructure sector and plans to increase it to Rs 800 billion over 2007-11.
CONCLUSION:
In low income economies like India, innovative and diverse financing techniques like setting up of infrastructural development bank, creation of infrastructure bond, development of domestic capital market, privatization, promotion of contractual savings etc., are needed to support an accelerating transition from public sector to private sector in the provision infrastructure sector. The five year plans in India have devoted considerable attention and earmarked between 55 per cent and 63 per cent of the total plan outlays on infrastructure development which have brought about substantial increase in these facilities. But still because of the poorly targeted subsidies and managerial inefficiency in the public sector critical infrastructure goods and services are under provided thereby choking development process. Unless the capacities are augmented and operational efficiencies improved, the infrastructure sector would be under greater strain. There is critical need to attract investment in infrastructure. An investor is interested in a transparent system, consistent policy and a situation where the public and private sectors equally competitive. To attract the kind of investment required there is urgent need for clarity in policy, regulating and administrative roles and responsibilities.