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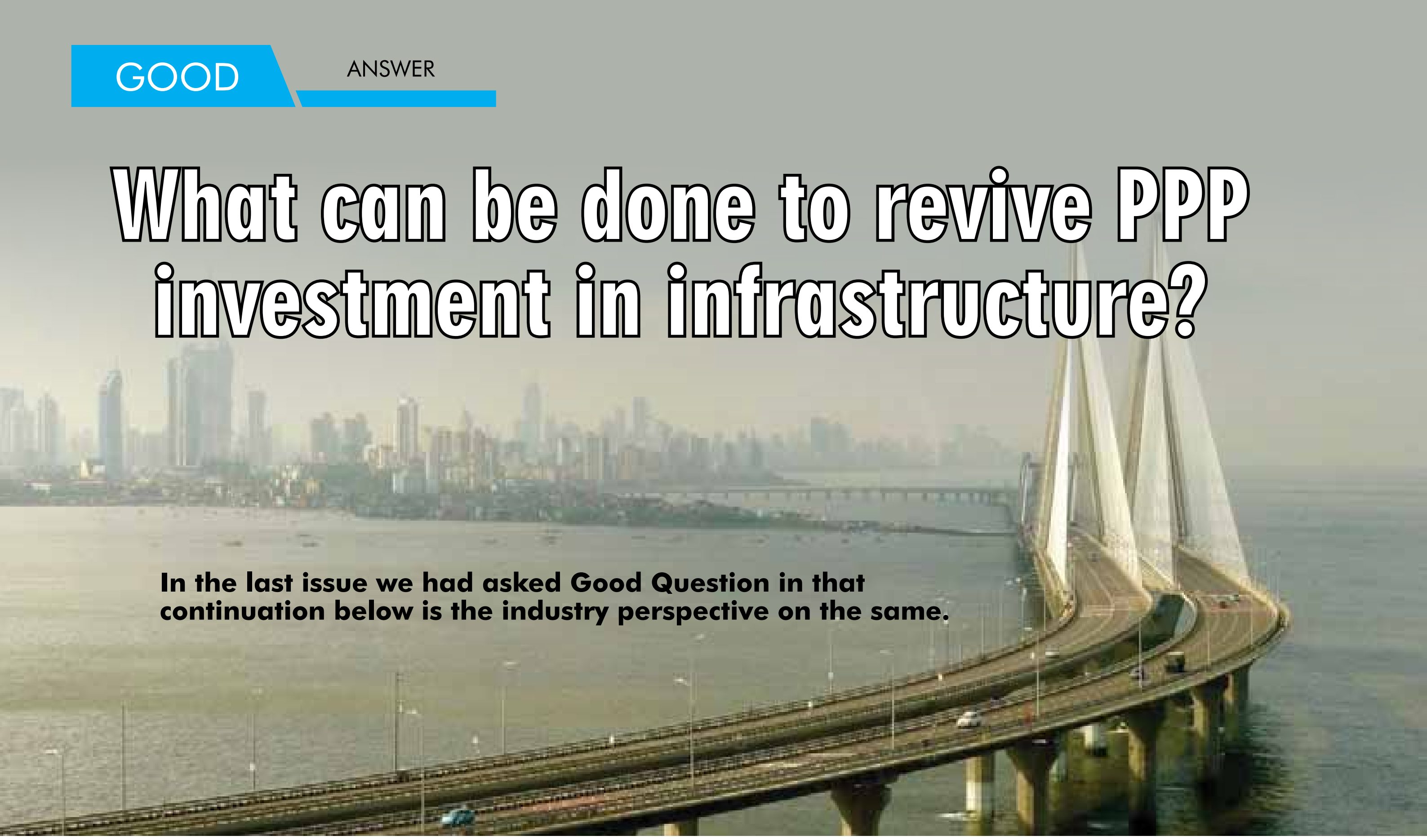
CONSTRUCTION TIMES

RNI NO.: MAHENG/2014/55864 ■ VOL. 5 ■ ISSUE: 1 ■ MUMBAI ■ MAY 2018 ■ PRICE: ₹ 100 ■ PAGES:82

INSIDE

Ensuring formalisation of the Indian real estate industry



What can be done to revive PPP investment in infrastructure?

In the last issue we had asked Good Question in that continuation below is the industry perspective on the same.

India, the world's fourth-fastest growing economy is facing the challenge of declining rate of investments in Infrastructure. Government has also accepted that it is battling a slowdown. Private sector is a major contributor to overall investments in India with 37 per cent share in capital formation. Foreign Direct Investments (FDI) too, though rising, account for only one-fourth of total private investments. Thus, domestic private investments form the bulk of private investments, and unless these accelerate, investment cycle will not see a turnaround. In the face of adverse GDP data, falling investment demand, declining industrial production, rising unemployment, and weakening consumer confidence, the government is trying to put together a revival roadmap.

Major Challenge

40 per cent of India's corporate debt is held by corporates with an interest coverage ratio of less than one. This suggests an acute stress in the corporate sector. The investment growth and GDP growth reaching 8 per cent over the next decade would push investments from around 30 per cent of GDP in FY17 to 35 per cent of GDP in FY27. In aggregate terms, nominal GDP could rise from $2.2 trillion in FY17 to $6.8 trillion in FY27. Private corporate sector would remain the largest source of investments rising from $272 billion to $905 billion over next 10 years. Therefore, cumulative investment in infra sector over the next 10 years is estimated to be $14.3 trillion. Private investments remain the largest component of overall capital formation; the recovery in private investment remains a prerequisite for investment growth to rebound to double digits. Growth in private investments has remained weak primarily due to concerns related to demand, credit and regulatory challenges.

Major catalysts that could help investment recovery in PPP Projects are:

Easing of corporate leverage by way of monetisation. The corporate leverage could ease up with the asset sales and fresh capital raising. However, with India's private sector debt-to-GDP at less than 60 per cent of GDP, considerably below the Emerging Market (EM) average of 137 per cent of GDP and advanced economy (AE) average of 160 per cent of GDP, there is visible scope for Indian companies to take debt even while the bad debt problem clears up. Roughly, even a 16 per cent annual rise in private debt would push the private debt to close to 80 per cent of GDP, still a favourable condition among the rest of the EM pack.

NPA resolution

Meanwhile, companies are also finding it difficult to raise loans. Saddled with toxic loans of close to Rs 10 lakh crore, Indian banks have been selective in lending. In recent months, the government and the Reserve Bank of India have taken several steps to clear the mess in the banking sector, including taking some of the large defaulters to the bankruptcy court. Nonetheless, it will be a while before the NPA problem is resolved.

While there has been considerable action to improve the financial health of the banking industry (especially with the amendment of Banking Regulation Act and setting up of Insolvency and Bankruptcy Code), there is also a need for development of financial institutions to cater to the long-term funding requirements for sectors like infrastructure. The depiction of the new Insolvency and Bankruptcy Code (IBC) process and the bank-recapitalisation plan has accelerated the recognition and resolution of banking sector NPAs, enabling the PSBs to restart the lending cycle. The bank credit growth has now reached 10 per cent y-o-y. Even a 16 per cent growth in credit over the next 10 years could keep overall debt within 80 per cent of GDP, which would still be significantly lower than the EM average.

Stability in government and its policies

One of the proximate causes for the decline in investments has been the accentuation of macro instability as reflected in high inflation, high interest rates, higher deficits, and a depreciating currency. This issue has been addressed through a formal adoption of a flexible inflation targeting framework by India's central bank with attendant benefits for inflation and interest rates, as well as on the real exchange rate front. The lower and stable inflation regime is likely to allow nominal rates and real rates to drift lower over the longer term and become a tailwind for investment growth. India's bank rates are one of the highest among the world, so clearly there is space for real rates to come down.

Revival of companies growth

Low corporate earnings growth in the last 10 yearshas been a drag on private capital expenditure recovery. Company earnings are still remains low compared to pre-financial crisis levels.

Lower the tax rates

Among other catalysts, the tax rate in India has room to come down. Fact is that India's effective corporate tax rates have gone up despite tax rate cuts for smaller firms.The effective tax rate of Indian firms is around 28 per cent and is comparable to EM peers such as Mexico and Brazil but higher than most other countries, including China. Any other competitive corporate tax rate cuts post the new US regime, could also necessitate a need to adjust India's corporate tax rate cuts. In terms of composition, the corporate tax has room to become more progressive and currently favours capital-intensive industries.

Reforms, productivity and investment

The government's thrust on structural reforms and improving productivity parameters could help a revival in private investments. Reform driven capital investments by a firm could by itself enhance productivity and offer economies of scale benefits, leading to a further increase in investments. The virtuous cycle could be set in motion with a relentless pursuit for globally competitive and high productivity enterprises.

Rationalise the property circle rates

In some area there is huge difference between the Government Circle Rates and actual realisable (sale) rate of the properties. This difference is affecting the growth in reality sector. Government move to rationalize circle rates could help in reviving the reality sector and private investment in this sector.

Improvement in the process of government decisions and orking

Government should generate innovative ideas and establish a checklist of social concerns or even a wish list for the scheme while inviting private investments. Although Government is working hard to streamline the decision making process and bringing more transparency in the system but still a long way to go. Larger participation of the professional institutions and society would help to make the public policies transparent, durable and for the benefit of society. This would help the investors to think for longer perspective and is a pre-requisite for sustainable growth.

Conclusion

The success of PPP projects depends upon financial viability of the project and its meeting the expectation of the society. Unfortunately, presently PPP evaluation focuses exclusively on value-for-money from a financial perspective. To improve the chance of success and investment therein, the value of PPP scheme should also be built on social value and satisfaction of the end users. We have seen in the past that those PPP projects which were highly successful where those which met the expectation of the society and wherein public at large was beneficiary.

Therefore, I opine that private investment in India has a great potential to grow.

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The public-private partnership (PPP) model is important in infrastructure development projects despite there have been some failures in water, power and metro rail projects. But we have example of some successful implementation of PPP in airports, ports, roads and bridges. There is some good example of world's best airports built through PPP model, a few is in India as well. Although there are a number of potential risks associated with this model involving land acquisition, construction, environmental clearances and other contentious issues like termination of project before the contract period etc. Looking at our economic growth target and the ambitious infrastructure development plans of 100 smart cities, Housing for All, Clean Ganga Mission, Schemes for Water and Sanitation Infrastructure, Roads and Highways, and Electricity for all by increasing the capacity of conventional and renewable power projects; PPPs will be a good solution. Private sector has more expertise, good knowledge and an advantage in executing large and complex infrastructure projects and will do what it is paid to do, therefore incentives and performance requirements need to be clearly set out in the contract.

Focus should be on performance that is output based, relatively easy to monitor and to make the project viable. Given the long-term nature of PPP projects and the complexity associated, it is difficult to identify all possible risk points during project development and issues may arise that were not anticipated in the documents or by the parties at the time of the contract. It is also possible that some of the projects may fail or may be terminated prior to the projected term for a number of reasons including changes in government policy, failure by the developer or the government to perform their obligations or indeed due to external circumstances.

While some of these issues will be able to be addressed in the PPP agreement, some of them will need to renegotiate and to be managed during the course of the project to accommodate contingencies for the successful implementation. To revive India's infrastructure sector under PPP model, we need to consider increasing public spending in construction activities; make financing for infrastructure projects easier and review the current PPP model to make changes in order to attract investors and learn from failures and past experiences. The private sector can make a big difference in infrastructure development under PPP mode with long-term investment and financing plans to identify revenue sources as well as the extent of financing that can be enabled.

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