Financing Infrastructure Projects in an Evolving Setting

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It is well-recognised that appraisal and monitoring of projects, especially infrastructure projects, is a highly specialized job to be done by multi-displinary specialists. This is particularly so because it involves making several choices like conveniences of, and acceptability by, different segments of the population; suitability of technology; complexity of financial modeling; commercial considerations; socio-economic implications; and also whether the environments in which they operate are in harmony with the projects while in operation. Visualising these issues requires not only in-depth analyses but also highly imaginative skills. There has to be a team which has access to knowledge pools from diverse sources. Thus, any organization engaged in this task of building infrastructure as also the financing entities that assist them should look into their all-round strength.

In India, development finance institutions (DFIs) as specialized institutions have had expertise developed over the past 5 decades. They have been doing appraisal for extending long-term assistance for *industrial* projects and monitoring them. Established and operating in the 1950s and the 1960s onwards when India laid greater emphasis on industrial projects under the planned economic development, they did not develop specialized expertise for appraising and monitoring diverse infrastructure projects, except, say, for power projects. They have been providing assistance mainly for industrial projects. The industrial establishments raised capital from the public, to begin with in a smaller way, and gradually on a relatively large scale. In the earlier setting, up to the early 1990s, the Controller of Capital Issues exercised control over their capital market activities.

Despite experience gained over 3 decades up to the mid-eighties, there were cost and time overruns and also non-performing assets. The projects were financed and supervised through a well-knit inter-institutional mechanism. There were frequent exchange of views on funding and monitoring of the projects and taking unified action by the financial institutions such as Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India Ltd. (ICICI) and Industrial Finance Corporation of India (IFCI) as also investment institutions like Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) and Unit Trust of India (UTI). The point of significance is that despite such joint efforts in respect of industrial projects, things were not up to the mark and therefore when large infrastructure projects are being built there is all the greater need for financing entities to operate on a joint basis so that the expertise and resources could be better marshaled and utilized more efficiently and effectively.

In this context, it is worth underlining how important is each phase of a project cycle. Project cycle is a process. What is not done, or done mistakenly or inadequately, be rectified as part of course correction in subsequent stages before the project is completed. It is a moving experiment. A project cycle comprises identification of a project idea, preparing feasibility report, then going ahead with a detailed project report, presenting it for credit appraisal by financiers, negotiating with them for the firming up of the project cost and means of finance therefor as well as the terms and conditions of financing, schedule of implementation for the project with supervision and

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follow-up mechanism in place and finally completion of the project and reviewing it as to how far the originally conceived project with the underlying assumptions has reached the stage of fruition in its entirety. Thus, every phase is as important as another. This pattern largely holds good for all projects, including infrastructure projects.

Since the 1990s, project work is done by all players in the capital market. This has resulted in shifting the appraising job from specialists to generalists in banks, investment/ finance companies and consultancy organizations. The Infrastructure Leasing & Financial Services Ltd. (IL & FS) was established in the mid-eighties as a forerunner in the infrastructure financing field. Through their skills, they could 'sell' their 'products'. Further, appraisal of infrastructure projects in a liberalized economy is all the more complex. Also, the data for project formulation are rather sketchy. The assumptions underlying and the timing for infrastructure projects should be debated more intensively. The likely time required for obtaining all requisite permissions/ approvals and legal and other documentation be assessed with minute care with a tinge of skepticism inasmuch as such work takes longer duration and involve greater complexities and quite often go beyond the control of the project management.

Land acquisition process would involve identification, price determination, contiguity issues, legal hitches, and unexpected and unintended consequences. Moreover, identifying well-suited resourceful civil and engineering contractors with capacity to mobilize men, money and material resources, the placement/purchase of machinery and equipment, especially for long-delivery items, are complex management decisions to be taken in time. At the outset, the management should be able to visualize as to how to get financial closure in the best possible way, and also chalk out a realistic implementation schedule. The initial work should be done well as part of the preparatory work. The government authorities concerned, principal investors, financing agencies/institutions should totally commit themselves for the project. For infrastructure projects, identifying and acquiring land is a major job requiring consents of diverse people. Several sensitive issues are to be tackled in time and with finesse. However strong the implementing agency might look *prima facie*, taking all relevant issues, its strength and future potential for being able to provide continued leadership be carefully assessed.

The detailed project report might have several pitfalls and negotiations for finance might require special skill. The appraisal and negotiation stages in the project cycle are course-correction phases. Hence, the managements should be open to ideas/suggestions from external sources, including the lending agencies. The consensus based on outside experience for financing the project, in effect, is a major determinant factor. In India, broad commitment by a few investors and financiers is the beginning of the project schedule. The financing institutions and the promoters concerned tend to estimate project cost lower and leave a larger gap in the financial structure for being 'arranged' by the project management from other financing agencies and / or investors They also avoid longer project schedule in the optimistic assessment they tend to make . as a matter of convenience and routine exercise to get the project going. The promoters also accept relatively short moratorium period as prescribed by the lenders without taking a more realistic joint view on the required gestation period. The lenders fix higher amounts of loan instalments and the rate of interest is charged based on lenders' 'risk perception' which, in simple language, means that the weaker the project, the higher the rate, pushing the borrower to the brink of further weakening it. Finally, the lenders pin their hope on the management to resolve issues on an on-going basis. This is sowing the seeds of time and cost overruns and being in chagrin at a later crucial stage.

There is a feeling that time and cost over-runs are inevitable and that all concerned take them for granted with the fond hope that the lenders and others concerned would salvage the project "in due course". An attitudinal change is essential. In fact, the overrun is hidden until the funds from out of earlier sanctions are drawn from the lenders. Such built-in overruns could be because of : inability to estimate the project cost, delay in arranging promoters' funds, some items — knowingly or unknowingly — not having been provided for, some extra provision going waste, or for external factors like currency fluctuations, change in duty structure, and such other internal and external factors, some of which would be beyond the control of the managements or financing entities.

In the context of massive resource requirements for the infrastructure projects, and the need to utilize the diverse expertise available with different organizations, private or public, it is better that the earlier mechanism of joint financing and monitoring by institutions and related organizations is reintroduced. All institutions dealing with large infrastructure projects like IDBI, Infrastructure Leasing & Financing Services (IL & FS), Infrastructure Development Finance Corporation (IDFC), Rural Reconstruction Corporation (REC), and the rest could finance projects jointly and arrive at decisions on related issues on consensus. India has large pool of experienced personnel, working or retired, who had worked in various governmental and private infrastructure projects. They could be a good source to draw upon. Their rich experiences should be handy. There are several areas which call for initiatives. Once the private-public-semi-private-semi-public institutions and experts start operating, their interactions will lead to faster pace in development of infrastructure like transport, water management, building sanitation facilities, houses for the growing population and infrastructure in rural areas. There is a great need for interactive mechanisms, awareness building and creating enthusiasm among the needy as well as the experts.

In this context, it is worth considering as to how best to utilize the sovereign wealth funds (SWFs) for infrastructure schemes and modernization in the reform era. Bringing in domestic and outside SWFs into the vortex of infrastructure development projects will usher in a new era of collaborative endeavour. Such funds have come into being from out of the vast resources in a community and using them for strengthening the economies is a very justifiable asset-building human endeavour. The funds being people's savings, they should be deployed for creation of national long-term assets. Hence, the job assumes a great deal of importance as the most skilful and imaginative one. If the governments concerned are imbibed with reform spirit and development-mindedness, the entire economic system, political network and social fabric will adjust themselves to the context and an era of all-round growth with human face should emerge on a steady basis.

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