Our Views

Financing for greenfield Infrastructure projects – a DFI could be a start

For any developing country, including for India, financing of greenfield infrastructure project is a challenge. Generally, these projects are not commercially viable and do not provide high return. At the same time, they carry multiple risks such as risk of execution, tariff collection and escalation in financing cost. Therefore, it is important for the government to set out a structured financing mechanism for these projects.

Recently, we have heard talks of setting up of another Development Financial Institution (DFI) by the government to facilitate financing of greenfield infrastructure project.

The earlier DFIs, in their previous avatar, were created during the pre-economic liberalization era. During that period, given the controlled nature of the economy and a protected industry, lending to industry was relatively simpler. Business model of DFIs was uncomplicated. On the liability side, they could raise low-cost long-term resources through various regulatory dispensations - at one point, DFIs even had special status for the purpose of investment by Provident Funds, etc. On the lending side, since the industry was well protected, the financier's money was not at any risk. Given that capacity, pricing, and consumption for each industry were regulated, there was always excess demand compared to supply of goods. Some of us will recollect the long wait-time to procure a scooter or a car few decades back. With minimal risk of Non-Performing Assets (NPAs), DFIs were lending at higher rates and making a good spread and return on investment. They didn't shy away from financing even long-term greenfield infrastructure projects. The concept clearly worked in that environment.

Post the economic liberalization in 1991, when the industry started opening and a lot of special benefits to DFIs were withdrawn, the equation suddenly changed. At that time, there were three large DFIs that were involved in large greenfield industrial projects financing - IDBI, ICICI and IFCI. Also, SIDBI, a subsidiary of IDBI was focused on MSME financing.

With the changed business model post the economic liberalization, the DFIs had to compete in the market for raising liability funds. There were challenges such as assets-liability mismatch because of market related borrowing, pricing & tenure mismatch, and market volatility. Further, the industries also became more competitive and started focusing on alternate sources of fund raising. This led to a complete collapse of the DFIs concept, leading to conversion of IDBI and ICICI into commercial banks. IFCI is still struggling despite the government support. Subsequently, another attempt was made in 1997 to set up an institutional financial mechanism for infrastructure project through formation of IDFC, a public- private partnership with Government ownership below 50%. However, today, even IDFC is functioning as a commercial bank.

Therefore, the question remains whether DFI alone is a solution for long term greenfield infrastructure project financing? We can look for guidance from the methodologies adopted for large long-term financing of greenfield infrastructure projects by two major global economies, i.e. China and America. While China used regulated lending by the banking system, which was in turn funded by the government through the budgetary support, the USA used the market mechanism to finance infrastructure projects.

To be more effective, India could follow a combined approach i.e., to have an institutional set up which provides support from the government and an appropriate market mechanism. While the DFIs can directly fund projects, it is important to promote financing through bond markets. While our equity capital markets are mature, DFIs could focus on developing and deepening the corporate bond markets, which requires -

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1. An appropriate credit enhancement agency - Generally, infrastructure companies will have below investment grade rating in the initial years. A structured credit enhancement program can put the additional layer of security and make these bonds investment grade which can then be placed out in the capital markets. A DFI can play an important role to provide the credit enhancement. This will also result in proper risk distribution through sell-down
2. Liquidity in the bond markets – For a vibrant bond market, appropriate liquidity is a must. At the current nascent stage, the Indian bond markets require support for development. DFIs can play an important role by providing liquidity support to various players in the market who could then make the market more liquid
3. Attract existing and new investors – for any markets to become deep, we need more investors. We need to attract more domestic retail investors who are a long-term investors and international institutions to provide the proper depth in the market

In summary, financing for greenfield infrastructure project is important for country's progress and the thought to set up a DFI is timely. However, a simple DFI structure alone may not be able to resolve the infrastructure financing issues. It should be supplemented with a vibrant and liquid corporate bond market and an adequate credit enhancement mechanism.

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