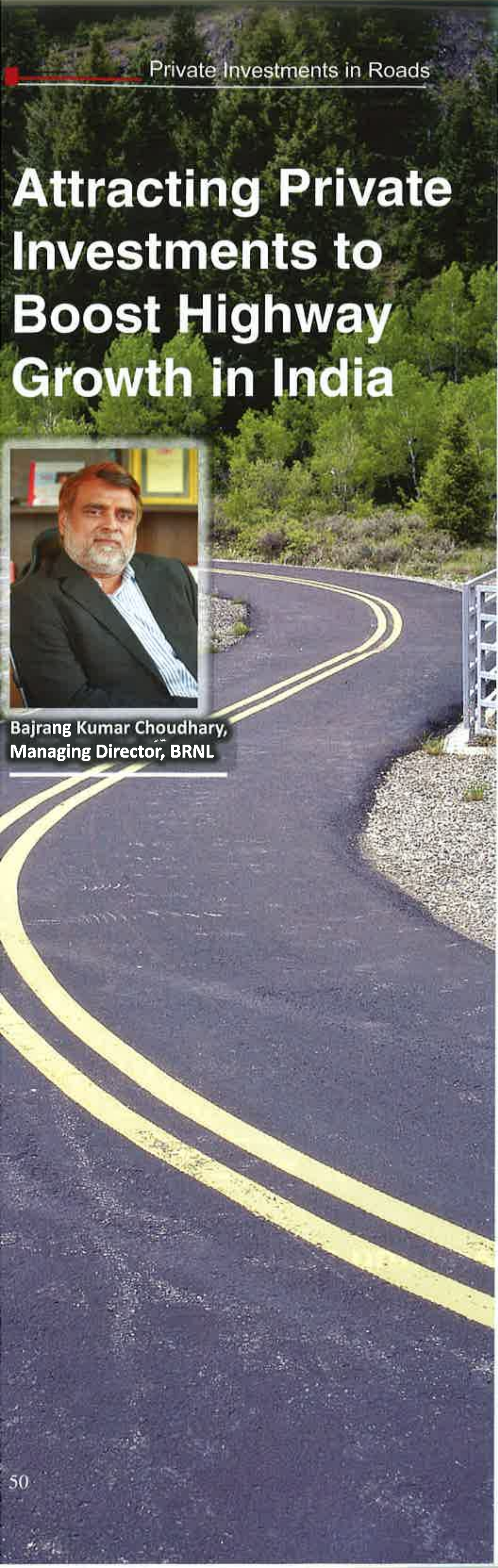
Attracting Private Investments to Boost Highway Growth in India



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Ever since India set out on a path of economic liberalization in 1991, the policymakers for almost three decades remained focused on developing infrastructure to commensurate with the economic growth of the nation. But the task was humongous and the resources, both technical and financial, limited. As the old saying goes, every challenge offers an opportunity for innovation. The budgetary constraints to support such large scale infrastructure creation actually paved the way for private investment in infrastructure sector.

With the advent of Public Private Partnership (PPP) model for infra development, India leapfrogged into the race for the fastest growing major economies. However, despite the success of the PPP model in Highway development, some questions still remained on its efficacy. Many execution models have been attempted such as BOT (Toll), BOT (Annuity), OMT and even the recently formulated HAM and TOT. But a foolproof PPP model still remains elusive. It is, therefore, important to delve deeper into some of the major issues plaguing the infra sector, find solutions, and attract private investment.

First, let's go back to the basics. The perceived failure of PPP is not because of lack of intent but mainly due to missing the moot point that the core essence of PPP is not just inviting private investments but encouraging private participation. Everything else is secondary. There's a typical political rhetoric in democracies worldwide and more particularly in India wherein the private entities are looked upon by the people at large as a monstrous profit making machines. The role of public authorities is therefore critical in restoring the true spirit of partnership. Authority must move away from policing the private partner and rather act as a facilitator. The message must be loud and clear that public infrastructure needs private expertise and investments and private players need public support to make their business profitable and sustainable.

Second, let's clear the hurdles on the existing path before charting a new path. We have seen policymakers tinkering too much with the execution model rather than sorting out the elementary barriers to growth. Whether we try EPC, BOT (Toll), HAM or BOT (Annuity), unless the issues of land acquisition, dispute resolution, and liquidity crisis are adequately addressed, the volatility in the sector would haunt the policymakers and infrastructure players.

Much before the signs of strain started showing up in the PPP space in India, the BOT (toll) was clearly the frontrunner in transportation infrastructure development in India. The success of BOT (Toll) was so emphatic that almost every other contract was being awarded in PPP, and the EPC contract dried up completely. There was no judicious mix based on viability. This forced the companies with expertise in engineering to explore the uncharted territory of asset management and handling O&M responsibilities.

Aggressive bidding to build up order book further added insult to injury and thus the breakdown was imminent. These contractors were mostly found over-leveraging their balance sheet and struggling to match their revenue with overestimated traffic projections. Their inability to repay debt led the sector to a vicious circle. The loans turned bad, lenders become reluctant to extend their exposure to road projects and subsequently the sector witnessed an unprecedented slump.

The downhill journey in the sector was quite sharp till 2014-15 when the kneejerk sectoral reforms by way of trying out new models (Hybrid Annuity Model), easing out exit norms and bringing the focus back on EPC mode brought some buoyancy in the market. Increasing public allocation for Highway development helped in putting the highway development back on track and also helped many small and medium contractors to build up their order book without compromising on their core efficiency. Such interim reliefs, though necessary, were definitely not the sustainable solution because we didn't deal with the real problem that was plaguing the sector. Besides the budgetary constraints of continuing the public funding, the private sector expertise in operation and maintenance is also required for managing the infrastructure assets, hence, it is indeed difficult to sustain project awarding momentum in cash contract without adequately supplementing it with BOT (toll) or HAM projects.

It is undeniable that infrastructure is one of the most complex business models which requires expertise to ideate, implement, and maintain. It is thus imperative to leverage private sector efficiencies for infrastructure development and management.

While globally, infrastructure development had so far cruised ahead by leaps and bounds, the infrastructure development in India has remained slow and sluggish. The market continued to struggle from need of funds and expertise to manage the infra. It has now become imminent to the policy makers to push the envelope and try out new and radical ideas.

Some possible steps to bring back investor confidence:

Reassess L1 bidding criteria: Taking a cue from aggressive bidding from small fringe infrastructure players who sometimes become overzealous to build up their order book and come up with absolute untenable business projections, the policymakers should now look beyond the L1 bidding criteria and rather award the projects to bidders who are the closest to the median of the bidding amount submitted by various bid participants. This would bring much more rationality in bidding and ease out the project hurdles due to execution inefficiencies.

Faster Dispute Resolution Mechanism: When you are entering into a contractual obligation under a concession agreement for a period ranging from 3 to 30 years, the disputes, either minor or major, between the contracting parties are likely to occur more often than not. It is thus imperative to put in a place a robust dispute resolution mechanism which would aim to settle the disputes in a time-bound manner.

It is indeed alarming to know that there are almost 1,014 arbitration cases and 730 court cases involving ₹55,345 crore, pending with NHAI under arbitration. Unless, both the private players and the public authority come forward together with a hunger for faster resolution and show equal amount of accountability towards the successful project implementation. The disputes and disagreements would continue to cause irreparable harm to the industry, unless we could really stop dragging small disagreements to arbitration and court proceedings.

The Arbitration Logjam: The issue of dispute resolution has for long needed some concrete resolution plan. With an objective to ease out the stress on developers entangled in disputes, NITI Aayog came up with the policy to release 75% of arbitration award upon submission of Bank Guarantee. However, the efficacy of the policy fails to yield the desired results unless lenders extend support for

the guarantee. Considering the constantly shrinking elbow rooms for the Public Sector Banks in extending line of credit to the infrastructure sector, banks are increasingly reluctant to issue Bank Guarantees without adequate collaterals. Hence, despite winning favourable arbitration awards, road developers are finding it difficult to clear the arbitration deadlock and thus Niti Aayog circular had a limited impact on the liquidity of developers.

Amid this scenario, it would be encouraging for the sector if the registered and recognized Public Finance Institutions are also allowed to issue guarantee for the release of such arbitration award. This will not only help in getting things moving for the contractors winning the arbitration award, but also help in easing out the stress on the banking system. A similar measure may be adopted for Performance Guarantees by enabling PFIs to issue Bid Security and Performance Guarantees in favour of bidding entities.

Rising from the Shadows of Cash flow Mismatch: Default in repayment and liquidity squeeze triggered by cashflow mismatch are unfortunately emerging as intrinsic components of the infrastructure development business. It is pertinent to note here that most of the BOT (toll) projects awarded during initial phase of

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PPP boom comprised of a concession period of 20-25 years, whereas the average debt tenor had traditionally been around 12-15 years. Despite performing reasonably well, most of these projects are on the verge of turning NPA solely due to cashflow mismatch. RBI must therefore allow restructuring of such projects and realigning the cashflow for undoing the wrong of the past and preventing an asset from turning bad merely due to cashflow mismatch.

Horses for the Courses Approach for Project Execution: The judicious mix of project execution between BOT (Toll), BOT (Annuity), HAM and EPC would enable infrastructure players to focus on their expertise and opt only for the projects aligned to their business interest and goals. While EPC projects with public funding will keep the order book flowing for the EPC contractors, projects under BOT (Toll) and HAM would attract investments from private players looking at value accretion leveraging asset management skillset.

Facilitating Asset Monetisation: The euphoric response from global pension funds and private equity players in TOT reflects the interest of global players in operational road projects. While the Government aims to mop up almost ₹10,000 cr from asset monetization under TOT in FY20, it must also facilitate similar asset monetization initiatives by debt laden private players who are looking to exit operational projects and free up their cash flows. The exit clause for operational road projects therefore needs to be further streamlined and the approval process for such stake sale and transfer needs to be made time bound to encourage more private participation. The risk-averse global players would not keep their interest intact on the Indian market unless we could comfort them with a favourable regulatory regime facilitating their asset evaluation and acquisition process.

The curious case of a 'P' in PPP: We started PPP with an aim to encourage Public Private Partnership for infrastructure creation but somehow waylaid ourselves midway and added a fourth P – Problem due to our approach. Time has come that we have to throw this P out and come back to PPP where the third 'P – PARTNERSHIP' has to stand out in India's quest for USD 5 trillion economy.

While the global economy is seemingly affected by uncertainties emanating from rising trade protectionism and political instability, the infrastructure sector could act as the stimulus for achieving the USD 5 trillion economy target within 2024-25. We, the Government, Authority, Lenders, Private Sector and Regulator, have to work together on a mission mode to build India as an economic powerhouse as envisioned by the Government of India. We owe it to our Motherland and can make this happen with our collective effort and wisdom.