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CURSOR India needs thousands of small infrastructure operators, not just a handful of big ones

Get Infra Out of Zombieland

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It is not unusual for construction workers excavating sites to stumble on ruins or even dinosaur fossils in certain parts of the world. In India, excavation of construction sites is likely to throw up the bones of infrastructure companies and non-banking finance companies (NBFCs) that financed them, which were nearly driven to extinction during the pandemic.

The death of small infrastructure companies is a tragedy, but when infrastructure finance companies (IFCs) die, they create horror stories, rising from the dead to haunt and blight the present: missing infra lenders starve the sector of funds, killing private activity in the sector. Infrastructure credit rose 1.7% in April, after falling 0.7% in the previous month, when the government hopes to revive growth on the strength of investment in infrastructure.

When the government offered multiple relief packages to the pandemic-hit economy in 2020, it left infrastructure out in the cold. All construction halted as pandemic-struck workers received no wages and trundled off home, to their distant villages. Their employers needed loans, mostly from NBFCs, to be rolled over. The Reserve Bank of India (RBI) offered to let banks refinance NBFCs that lent to small and medium enterprises, but not those that lent to infrastructure.

Probably bitter memories of the fraudulent IFCs, such as IL&FS and Dewan Housing, held the regulator's hand. Whatever the cause, the effect has been deadly for infrastructure players. With stalled projects and unable to service or roll over their loans, project developers and implementers shrivelled and died. NBFCs that failed to get paid find new takers for the leased equipment they repossessed or raise fresh loans followed in their wake.

Of course, just because RBI did not have a special liquidity window for refinancing IFCs, it did not follow that banks should not refinance their clients. But saddled with NPAs and placed under the regulatory thumb as never before, it took an extraordinarily brave banker to go to the aid of IFCs. Bankers chose the better part of valour.

India is a developing country. Its developers are in the same state of development — they are not self-realised developers when they start. GMR had not developed an airport before he built his first one. The Kochi airport was built by a company headed by an IAS officer on deputation. If such people were to apply for most infrastructure projects on offer from the government now, they would be disqualified at the outset — prior experience is now compulsory. So is a net worth of at least ₹500 crore.

These restrictive conditions favour multinational companies and Indian companies that have made it big. When the likes of GMR and GVK grew into infrastructure majors, they had not started off on the strength of huge net worth. Entrepreneurial chutzpah was their key asset. And they had financing support from IFCs that could see the potential beyond rules and manuals and could innovate structures to mitigate the risk.

When, in the late 1990s, GMR came up with the idea of setting up a power plant that could run on naphtha or natural gas, mounted on a barge that could potentially be towed around the coast to wherever power was in short supply, the idea was outlandish. Bankers would not touch the project with a barge pole. SREI, an infrastructure financing company, took up the challenge. Its business model was to set up special purpose vehicles for the equipment it financed and set up escrow accounts into which project revenues would flow, with the first charge on the revenue for financing its credit. The Tannir Bavi barge project was commissioned in 2001. That it finally ended up in Kakinada, switched to gas and failed when policy denied gas to power generation is a different story.

SREI now finds itself in insolvency. Not that it defaulted on any loan, but because its provisioning for troubled loans fell short of the RBI's norms and because it seemed to operate through a maze of companies that confounds the typical banker used to tidy credit structures.

Indian infrastructure players pull themselves up by their chappal straps. Informal finance and IFCs finance their dreams and enterprise, not net worth. Some of them reach escape velocity and enter the big league. Those that fail and fall to the ground do not create much debris that would create collateral damage: the equipment they have financed can be repossessed and redeployed.

India needs a thriving army of developers and financiers as it builds the infrastructure for future prosperity. It cannot be left to one NaBFID and a handful of big players the banks can safely lend to. The government must develop the market for corporate bonds, including subprime ones, along with a functional market of derivatives to hedge against credit, interest and currency risk, free of transaction taxes.

IFCs should be able to tap this market besides projects that have crossed the development stage. Banks should finance intermediaries, such as IFCs, that understand infrastructure rather than build awkward asset-liability mismatches with direct exposure to infrastructure with longish gestation periods.

Let's not leave things undead on the home front