

GENERATION OF FINANCES FOR POWER
SECTOR

IS IT A CHALLENGE? IS FINANCE REALLY
NOT AVAILABLE?

OR ARE WE BEING UNABLE TO TAP THE
RIGHT AND AVAILABLE RESOURCES?

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OBJECTIVE: TO ADDRESS THE TWIN PROBLEM-ONE, OF LACK OF INVESTMENT IN INFRASTRUCTURE SECTOR AND THE OTHER, OF FINANCIAL INCLUSION AND UNBANKABILITY. CAN WE BRIDGE THE GAP BY A SINGLE STRATEGY?

ABSTRACT: The paper addresses the twin problem of lack of investment in infrastructure on one side and proper channelization and utilization of rural savings due to “unbankability” and absence of financial inclusion on the other. The power sector needs \$ 250 billion of investment in the next 8-9 years. The present scenario highlights the fact that following are the agencies through which generation of funds takes place. Or in other words, following are the bodies which invest in the power sector presently:

- Government and SPVs floated by the government invest in form of grants and loans.
- Banks which do structured deals for the industry. They undertake both short term and mid-term financing as well as working capital financing.
- NBFCs constituting of equipment lease finance companies, hire purchase companies, loan companies and investment companies. These companies take up specialized financing and project financing deals.
- Stock exchanges through IPOs and FPOs.
- Foreign direct investments(FDI) which is allowed upto 100% investment in power projects
- Other foreign sources of finance.

There is a unique problem associated with each of these bodies which renders the investment made by them inappropriate and unsuitable for infrastructure sector. And despite the fact that a huge investment is made in infrastructure or power sector, it is still inadequate.

The other problem being focused is financial inclusion. Unbanked areas are being tapped and covered, but they pose challenges and problems due to their nature. Also it takes resources in form of time, finances, manpower and commitments on the side of the financial body undertaking such a project or task, which, more or less the concerned agency is not willing to input.

Why not instead issue mid term infrastructure bonds backed by the government for residents of unbanked areas. This would solve the problem of financial inclusion to some extent. The finances generated through this channel can be invested in infrastructure thus solving the problem of lack of investment in the subject sector also. By the time the mid-term is over the infrastructure would have acquired a status of ‘industry posing risk of undertakable quantum’.

When the mid term is over the bonds can be purchased by private players who will be ready to undertake those measurable risks posed by the industry then. Since by then the base support system and the initialization would have been over the private players would be in a position to take the investment to further levels.

ISSUE AT HAND:

THE POWER INDUSTRY: STARVING FOR FINANCES OF SUITABLE NATURE:

According to the CII a Kearney study, the Indian power sector would require an investment of about \$250 billion (about Rs 12, 50, 000 cr) in the next 8 years of its growth. This poses a big question mark on the status of this quantum of investments. Where will this investment come from? What will be the source of these finances?

Let's begin the analysis by studying the sources of finance in the current scenario.

Following are the finance generating bodies of the Indian financial industry. These bodies invest in the power sector in the mentioned ways:

- **Government**, through long term loans and grants. According to the annual report 2008-09, Ministry of Power, under the R-APDRP "Initially 100% funds for part-A and 25% (90% for special category states) funds for Part-B projects shall be provided through loan from the Govt. of India. The balance funds for Part-B projects shall be raised from financial institutions. The entire amount of loan for part-A projects shall be converted into grant once the establishment of required base-line data system is achieved and verified by an independent agency appointed by MoP."
- **Banks**, both nationalized and private, through structured deals.
- **Non Banking Financial Companies**. The RBI regulations divide the NBFC's into the following categories.
 1. Lease finance companies
 2. Hire purchase companies
 3. Loan companies
 4. Investment companies

These companies do short term and very specialized find of financing for the subject sector.

- **Stock exchanges** in form of IPOs and FPOs
- **FDI and other international sources**.

But each of these has a unique problem. Or a concern associated with each of these agencies which makes the investment unsuitable to a large extent for the power and infrastructure industry.

- **Government**, although takes on the large amount of investment required in this core sector, but still it falls short of the quantum of investment required to set the ball rolling which clearly indicates that there is a dying need of additional finances to be generated and collected. I would add here that there is a large pool of idle finances lying in the heart of the nation, waiting to be reached and tapped by the government. The government and only the government can do it.
- In 1990, the World Bank presented a confidential report, *India: Financial Sector Report: Consolidation of the Financial System*, which was dittoed almost in full by the report of the Committee on the Financial System (June 1991), headed by M. Narasimham. The Bank and the Narasimham Committee report charted a course eliminating any measure of Government direction of finance to productive activities starved of capital, to social welfare needs, and to backward regions. Instead the **financial sector** would be free to concentrate on high-profit (and high-risk) activities such as speculation and consumer lending. Since then the banks with a view of earning higher profits prefer to earn higher and quicker profits from interest on government debt instruments, and trading in such instruments; from bigger margins on loans; and from housing loans to middle and upper class households. In the recent period, the character of the banks has changed even more. Large corporate sector firms have not wanted to borrow, since they were already burdened with excess capacity and low demand (indeed, they were not even willing to invest their own surplus cash in productive activity). On the other hand, the overall thrust of policy and practice since 1991 has conveyed to the banks that they need not bother with the difficult, low-profit job of lending to agriculture and small-scale industries, which requires manpower, branches in the rural areas, and commitment. So banks have instead placed their funds in Government debt, earning risk-free interest and using little manpower. Secondly, as the price of these Government debt instruments has risen recently, the banks have also been making profits trading in these instruments — which is a speculative profit, not much different from trading on the share market. The third trend to be noted in the banks' performance is the shift in their loan portfolio, from lending for production to lending for consumption of the better-off classes. In 2001-02 and 2002-03, this was strikingly seen in the case of housing loans, which are availed of by the middle and upper classes. The scheme of investment exhibits the fact that banks do not focus t investing in core industries due to quicker profit considerations

- **NBFC's** make specialized loans and investments in the sector with a profit motive from short to mid term. They are not concerned with the quality of contribution to the growth of the sector or the nation per se.
- **Stock exchanges** do input some percentage of the required investments but they are so largely affected by global ques, publically available information about companies and technical volatility that they do not prove to be a stable form of investment. A very less percentage of investors play on fundamentals and invest on longer term outlook based on the much heard of, the EIC framework.
- The factsheet of **foreign Direct investment** 'from August 1991 to March 2010' released by the Department Of Industrial Policy And Promotion (DIPP), Ministry of commerce and industry declares that out of a the total FDI from April 1991 to March 2010, only 4% has been contributed to power sector and only 11% to the complete infrastructure activities. This indicates that foreign investors also do not consider investment in the subject industry a lucrative one. The concerns could be the same as for our local investors.

These concerns crop up majorly due to the character of the sector which makes it less attractive for investment presently and these characters include:

- **Longer gestation period i.e a longer time taken for generation of cash flows.**
- **Lack of investment on part of investing agencies, a vicious circle.**
- **Absence of basic support system and initialization.**
- **Risks associated, such as financial, environmental etc.**
- **Lack of social approval and support.**
- **Clearances required for setting up an infrastructure related project.**
- **And many more**

This completes the demand side gap analysis which concludes at the fact that there is absence of a large quantum of suitable kind of investment needed for the power industry or the complete infrastructure sector for that matter to grow.

THE "UNBANKABILITY" OF RURAL POPULATION: A CONCERN OF FINANCIAL INCLUSION

The other side of the coin has another story. This side talks about a huge quantum of money lying idle in homes of the rural people of the unbanked areas. A December 2009 RBI report, "Financial Inclusion: Challenges and Opportunities," points out that the country has 600,000 habitations -- clusters where the population is 100 or more -- but only 30,000 have a

commercial bank branch. Less than half the population has a bank account, with the disparity greater in the northeast. Only about 10% of the people have life insurance, and less than 1% have other types of insurance. Indian banks, especially those in the public sector, have made substantial efforts to tap the country's rural population. But expanding through branches has been a costly -- and largely unsuccessful -- endeavor. Out of 50 public sector and private sector banks, 26 have therefore appointed Business Correspondents, through which eight million no-frills accounts have been opened as of March 31, 2009. Using banking correspondents in such a way is gaining in popularity globally. A recent RBI directive added six more types of correspondents -- including shop owners and public call office operators -- to the existing categories of microfinance institutions and nongovernment organizations. According to N. Kavitha, Research Scholar in Mother Teresa Women's University, Kodaikkanal and Dr. A. Ramachandran, Reader in Commerce, SNR Sons College, Coimbatore, banking in rural India is faced with the twin challenges of regulation and distribution. Regulation, with respect to banking as the banking structure has been designed for delivery in urban India and distribution, which means more manpower required to be deployed in rural areas

The question here is "Do we have an alternative to that? Can we do something faster, with lesser finances and manpower to include more rural people into the financial arena typically termed as 'financial inclusion'?" The answer is "**YES .WE CAN**". Why not introduce these rural masses to financial products such as government bonds and other such debt instruments having a government backing? The reasons why I advocate introduction of government bonds are:

- Bonds are easier to explain to a person completely ignorant about financial products as compared to a share etc. since they do not involve in themselves a complex mechanism.
- Less risky since a payback is assured. This is a benefit which would woo the rural to lend money.
- Since they are backed by the government, it is easier to persuade the rural people to buy them.
- Also not much of technology is required to introduce bonds.
- Lesser manpower is required as compared to a bank. A correspondent of the nearest bank could always take up the project.

A study published in a research paper on Dspace@iimk, IIMK's institutional repository, a scholarly archiving facility for the IIMK community, namely BUZZ-A spontaneous marketing tool in rural market for financial products reveals the fact that on 13% rural people, that too only graduates are aware about bonds.

This initiative could be a worthwhile financial inclusion exercise.

WHY NOT BRIDGE THE GAP?

THE STRATEGY

I take the privilege to build a scenario here. Let the Government Issue zero-coupon infrastructure or power bonds for mid term (say 5 years) especially for rural people residing in unbanked areas. The representatives from banks nearest to these areas visit the influencing group of the villages. Since these bonds come with government backing and guarantee, should be well accepted by the rural people. This would solve the problem of financial inclusion and “unbankability” to some extent within a short span of time for mid term. By doing this the rural get inclusion, understanding, income, confidence and support. This money can then be utilized for supply of funds to infrastructure projects which are starving for funds invested at long term. By the time this mid term is over the sector would have achieved the required kind and extent of stability necessary for the private financial players to take on investment from that point of time. Once this mid term is over let the bonds be purchased by those private players (again for mid term) who are ready to undertake the risks posed by the sector, then. By then the base and the support system for the growth of infrastructure or power industry would be laid down and the private players would be by then interested in taking those calculated and measurable risks posed by the sector then and the investment to the next level.

By following this strategy the government can solve the problem of all concerned parties:

- Rural, through financial inclusion.
- Government through inputting lesser amount of non profit generating finances such as grants, will be able to support the demand for investment in the subject sector. Also the government could retain a part of profits being generated by the projects by the

time 10 years are over. By the end the bonds can be converted to equity, a complete win-win game for the government.

- Infrastructure sector by getting the required kind of suitable investment for long term
- Private players, by getting quicker profits (within 5 years, according to the scenario built), and a stake in the end.

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