

# GRID LINES

Sharing knowledge, experiences, and innovations in public-private partnerships in infrastructure

## The role of developing country firms in infrastructure

### A new class of investors emerges

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**D**eveloping country investors have emerged as a major source of investment finance for infrastructure projects with private participation. Indeed, in 1998–2004 these investors accounted for more of this finance in transport across developing regions—and for more in South Asia and Sub-Saharan Africa—than did investors from developed countries. For policymakers this development suggests a need to rethink the criteria used in selecting investors in schemes for private participation, which have been biased toward large international operators.

In the early 1990s, after decades of poor performance by the public sector, developing countries increasingly sought to involve the private sector in providing infrastructure services through widespread privatization, deregulation, and structural reform. The efforts proved fruitful: developing countries saw investment commitments of nearly US\$755 billion in more than 2,400 public-private partnerships in infrastructure during the 1990s.<sup>1</sup> Large corporations from developed countries played a big part in this wave of activity. Among the most active were such companies as AES Corp, Electricité de France, Enron, Suez, Veolia, Telefónica, France Telecom, and Deutsche Telekom.

But the optimism evident early in the decade was dimming by its end. An estimated 40 percent of the contracts for infrastructure projects were being renegotiated.<sup>2</sup> Many multinational investors began reducing their exposure in developing countries, leaving

behind around 160 canceled or distressed projects over the period 1990–2004.<sup>3</sup> In a 2002 survey of 65 international investors in the power sector, about half reported being less interested in or retreating from developing countries (Lamech and Saeed 2003).

New players from developed countries have emerged. In the water sector, for example, they include Aquamundo of Germany, Acea of Italy, Aguas de Bilbao, Aguas de Portugal, and municipal water utilities from France and Germany (Harris 2003). But these companies have engaged far less in developing countries than their earlier counterparts.

Meanwhile local and regional operators and investors from developing countries have become more prominent.<sup>4</sup> In southern Africa companies like NetGroup (South Africa) and Electricity Distribution Management (Namibia) seek to extend their experience in low-cost rural electrification projects into broader investment and management opportunities in southern and East Africa (NetGroup won the Tanesco management contract in Tanzania). In 2004 Alusa Engenharia from Brazil engaged in three electricity transmission projects in its home country, and Chilean groups Solari, Luksic,

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and Consorcio Financiero dominated five of six water concession contracts secured in Chile. In the same year the Indian consortium of Rites and Ircon International won the contract for restoring and managing Mozambique's Beira rail system.

Anecdotal evidence such as this suggests that developing country investors have improved their position and are taking on a larger share of infrastructure investments. Three possible reasons for this: First, the broadening and deepening of capital markets in developing countries has enabled their investors to mobilize more resources. Second, the growing experience of these firms with infrastructure investments, often as minority partners with developed country investors, has given them more expertise. Third, these companies might well be in a better position to understand and therefore deal with the political economy issues in developing country infrastructure projects with private participation.

The evidence and assumptions outlined here justify analysis to more thoroughly assess the role of local and regional investors and operators in developing country infrastructure and to explore the policy implications. This note reports findings from the first phase of a PPIAF-funded study recently commissioned to do so (Ettinger and others 2005). The results presented here focus on the origin of the investment commitments that materialized in the 1,200 projects reaching financial closure in 1998–2004.<sup>5</sup>

## A larger role—but varied

Developing country investors have become a major source of finance for developing country infrastructure projects (figure 1).<sup>6</sup> For projects reaching financial closure in 1998–2004, these investors mobilized about 42 percent of the private funds. The large majority (29 percent) came from local companies investing in projects in their own country (“developing local” investors); of the rest (13 percent), almost all came from investors from nearby countries (together with cross-regional investors, “developing foreign”

investors).<sup>7</sup> But there are striking differences in the level and pattern of participation by developing country investors across types of projects, sectors, and regions.

## Across types of projects

Developing country investors contributed more than half the private investment in concessions (54 percent) in 1998–2004, slightly less than half in greenfield projects (44 percent), and a smaller share in divestitures (30 percent).

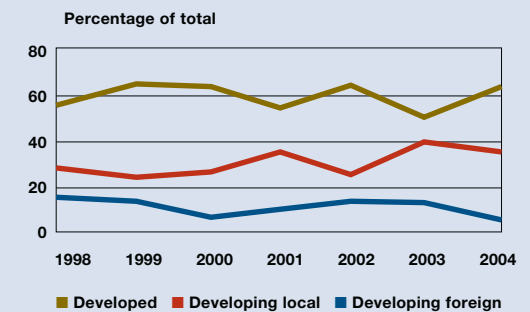
## Across sectors

Developing country investors accounted for as much as 52 percent of the private investment in transport and 46 percent in telecommunications in 1998–2004, but only about 27 percent in energy and 19

**FIGURE 1**

### Developing country investors now a major source of infrastructure finance

Private investment in developing country infrastructure projects by type of investor, 1998–2004

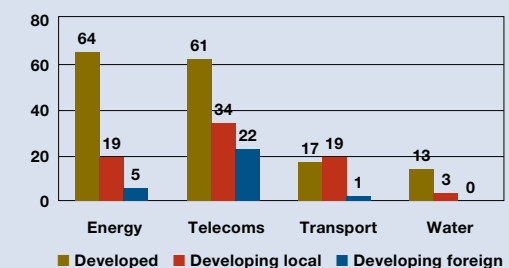


Source: Ettinger and others 2005, updated to include 2004 data.

**FIGURE 2**

### Developing country investors most important in transport and telecoms

Cumulative private investment in developing country infrastructure projects by type of investor and sector, 1998–2004

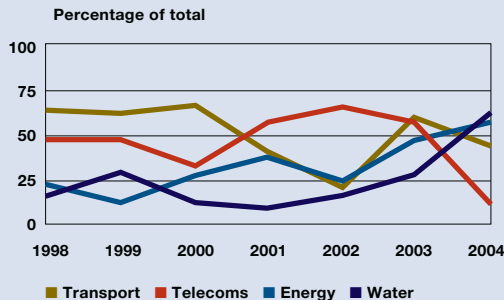


Source: Ettinger and others 2005, updated to include 2004 data.

**Developing country investors are taking on a larger share of infrastructure investments**

**FIGURE 3**  
**Mixed trends across sectors**

Developing country investors' share of private investment in developing country infrastructure projects by sector, 1998–2004



Source: Ettinger and others 2005, updated to include 2004 data.

percent in water (figure 2). In transport the large share typically reflects a relatively large number of local construction contractors, while in telecommunications it reflects mainly the investments of a few large firms such as America Movil and the Carso Group, both from Mexico, and MTN, from South Africa. The energy sector remains dominated by large utility firms from developed countries; the developing country players that have emerged tend to secure contracts for relatively small power systems.

The share of private investment from developing country investors has been rising in energy and water, but falling in telecommunications and transport (figure 3). Determining the exact reasons for these trends is difficult. But in the water sector the rising trend is explained at least in part by the involvement of local sponsors in several concession contracts recently awarded in Chile. Conversely, the reverse trend in telecommunications (particularly the sharp drop between 2003 and 2004) can be explained by the participation of investors from two developed countries, Kuwait and the United Arab Emirates, in the acquisition of licenses to provide mobile services in Algeria, Jordan, Pakistan, and Saudi Arabia—transactions accounting for 70 percent of total private investment in the sector in 1998–2004.

### *Across regions*

South Asia had the largest share of investment from local investors—55 percent of the region's total in 1998–2004. Moreover, the share from developed country investors declined over the period: while the average was 33 percent, it fell to just 19 percent in 2002–04. Local investors were the main sponsors in 62 percent of the region's projects.

East Asia and Pacific also had very active local investors, accounting for 42 percent of private investment in 1998–2004 and acting as the main sponsors in 36 percent of projects. Much of this investment was in telecommunications (where local investors contributed 65 percent) and transport (48 percent).

In Sub-Saharan Africa developing country investors accounted for 65 percent of private investment. But much of this came from private investors in South Africa alone.

Latin America and the Caribbean had the most private investment in infrastructure in 1998–2004—accounting for 59 percent of the developing world's total—so its results are strongly reflected in the global picture. This region also had the sharpest drop in private investment: in 2004 investment was only 9 percent of that in 1998. Developing country investors were the main sponsors of projects as often as developed country investors were, but these investors accounted for considerably more investment in 1998–2004.

Developed country investors dominated in Eastern Europe and Central Asia, with 78 percent of investment and 72 percent of projects, reflecting in large part the proximity and interest of Western European companies. Local firms have a significant role only in transport, accounting for 45 percent of investment.

The Middle East and North Africa had the fewest investments, with most of these in telecommunications, making it hard to discern clear patterns.

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## The implications? Still unclear

As large multinational utilities retreat from big infrastructure projects in emerging markets, especially in riskier and more politically sensitive countries and sectors, local and regional investors may be starting to fill the gap. In some regions they are willing to play as large a role as investors from developed countries.

The potential role of this investor class is encouraging. For policymakers it suggests a need to rethink privatization design, particularly the criteria used in selecting investors, which have been biased toward large international firms. The growth in new private infrastructure firms also matters because it should reduce the risk of collusion and other anticompetitive practices.

Other implications are less clear. Are local and regional investors better equipped than their developed country counterparts to deal with the political economy issues raised by private participation in infrastructure, as they are often assumed to be? It is too early to tell. Foreign participation can be politically sensitive, but consumers are often equally concerned that local firms are connected to the government and thus susceptible to corruption.

Do local firms have advantages in financing, as is also often assumed? They have better access to local currency equity capital and could have an edge in mobilizing local currency debt and thus mitigating foreign exchange risk. But if local capital markets are undeveloped and local term finance unavailable, these advantages will be relatively modest.<sup>8</sup> So while the recent rise of local and regional investors should be considered good news, neither its policy implications nor its sustainability has been clearly established yet.

### Notes

- 1 Data are from the Private Participation in Infrastructure (PPI) Project Database ([ppi.worldbank.org](http://ppi.worldbank.org)), which includes projects only in low- and middle-income countries, as classified by the World Bank. Country classifications and project information are updated annually. Data in this note are in 2004 U.S. dollars.
- 2 Excluding contracts in telecommunications (World Bank, Private Sector Advisory Services 2003).
- 3 Canceled projects are those in which private sponsors sell or transfer their economic interest back to the government; remove all management and personnel; or cease operation, service provision, or construction. Distressed projects are those under international arbitration or for which cancellation has been formally requested.
- 4 Examples here are from Harris (2003), updated to take account of recent changes.
- 5 The study, which drew on the PPI Project Database, chose 1998 as the starting point mainly because of data limitations relating to 1990–97. In addition, 1998 appeared to be a good starting point for assessing the blend of investors willing to invest in developing countries. That year marked the effective end of the early enthusiasm for private participation in infrastructure, with annual investment flows peaking in 1997, then falling sharply as several factors led to a reduction in both the size and the number of projects.
- 6 *Developing country investors* are firms majority-owned or controlled by shareholders from low- or middle-income economies, *developed country investors* by shareholders from high-income economies (as classified by the World Bank).
- 7 The calculation of investment shares assumes that each investor accounts for a share in total investment that is equal to its share in equity.
- 8 Conversely, if local capital markets are developed, it can be presumed that they are as readily available to foreign firms as to local ones.

### References

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