

GRID LINES

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

Updated
with 2005 and
2006 data

The role of developing country firms in infrastructure

New data confirm the emergence of a new class of investors

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Developing country investors have emerged as a major source of investment finance for infrastructure projects with private participation. This update of the article originally written by M. Schur, et al in 2006, shows that, indeed, during 1998–2006 these investors accounted for more of this finance in South Asia and East Asia and Pacific—and for more in transport across developing regions—than did investors from developed countries. Even though the policy implications are not yet fully clear for policy makers, 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 \$781 billion in more than 2,100 public-private partnerships in infrastructure during the 1990s.¹ Large corporations from developed countries played a big part in this wave of activity. Among the most active were such companies as AES, 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 (excluding telecommunications) were being renegotiated (World Bank, Private Sector Advisory Services

2003). Many multinational investors began reducing their exposure in developing countries, leaving behind about 153 canceled or distressed projects in 1990–2006.² 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.³ In southern Africa such companies as 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 2002. In 2004, Alusa Engenharia from Brazil engaged in four electricity transmission projects in its home country, and Chilean groups Solari, Luksic, and Consorcio Financiero dominated

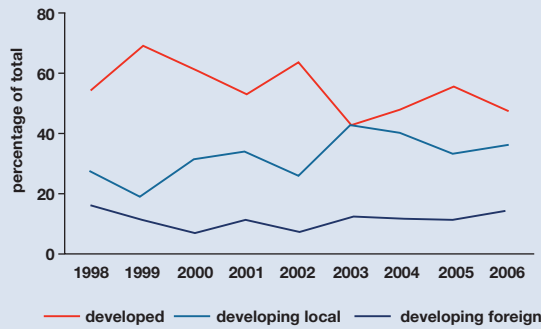
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FIGURE 1

Developing country investors now a major source of infrastructure finance

Private investment commitments to developing country infrastructure projects by type of investor, 1998–2006



Source: Ettinger and others 2005, updated to include years up to 2006.

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

In 2006 more local investors made commitments in their own country. In India, Lanco Group invested in five new electricity projects, and GMR Group in five new transport projects. In China, Chongqing Kangda Environmental Protection committed to invest in six water treatment plants. In the Russian Federation, Rosvodokanal (RVK) committed about \$370 million to three water utilities.

Such anecdotal evidence 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 commissioned to do so (Ettinger and others 2005). The results presented here focus on the origin of the investment commitments that materialized in 1998–2006 for 2,524 projects reaching financial closure during 1990–2006.⁴

A larger role—but varied

Developing country investors have become a major source of finance for developing country infrastructure projects (figure 1).⁵ These investors mobilized about 44 percent of the private investment committed to infrastructure projects with private participation during 1998–2006. Most (32 percent) came from local companies investing in projects in their own country (“developing local” investors); of the rest (12 percent), almost all came from investors from nearby countries (together with cross-regional investors, “developing foreign” investors).⁶ 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 (55 percent) during 1998–2006, half in build-operate-transfer (BOT) and other greenfield projects (50 percent), and a smaller share in divestitures (29 percent).

Across sectors

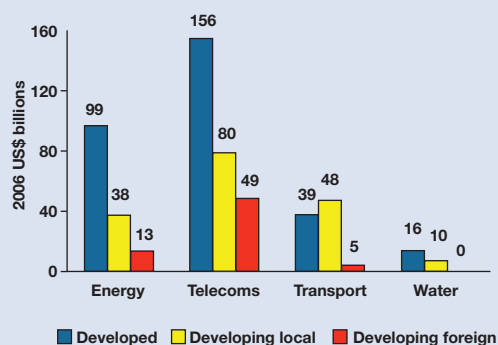
Developing country investors accounted for as much as 58 percent of the private investment commitments in transport during 1998–2006, and for 45 percent in telecommunications, 40 percent in water, and 34 percent in energy (figure 2). In transport the large share typically reflects a relatively large number of local construction contractors, while in telecommunications it reflects mainly the investments of a few large firms, such as America Movil and Telmex (from Mexico), Telemar Participacoes SA (Brazil), and MTN (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 volatile (figure 3). Determining the exact reasons for these trends is difficult.

Developing country investors are taking on an especially large role in transport

FIGURE 2**Developing country investors most important in transport and telecoms**

Cumulative private investment commitments to developing country infrastructure projects by type of investor and sector, 1998–2006



Source: Ettinger and others 2005, updated to include years up to 2006.

Developing country investors' share dropped for all sectors except telecommunications during 2001–02. Notably, the share fell to 10 percent for energy in 2002 and then quickly recovered to a high 58 percent the following year. The plunge in 2002 was due mostly to large investment commitments by three developed country sponsors, RWE and E.ON of Germany and Gaz de France; these amounted to \$8.2 billion, 46 percent of the total for the sector that year. In 2003, by contrast, the largest investment commitments were by two developing country sponsors, Farsighted Investment of China and Malakoff Bhd of Malaysia. These companies committed more than \$2 billion each in 2003, 25 percent of the total.

In the water sector a rising trend during 2001–04 is explained in part by the involvement of local sponsors in several concession contracts awarded in Chile. Conversely, the slightly downward trend in telecommunications after 2002 can be explained by the participation of developed country investors from Kuwait and the United Arab Emirates in the acquisition of licenses to provide mobile services in Algeria (since 2004), Pakistan (since 2003), and the Arab Republic of Egypt and Tunisia (since 2006).

Across regions

South Asia had the largest share of investment from local investors—60 percent of the region's total during 1998–2006. Local investors were the main sponsors in 56 percent of the region's proj-

ects. Investment commitments from local investors dominated all sectors, with those in water coming exclusively from local companies.

East Asia and Pacific also had active local investors; they accounted for 56 percent of private investment commitments during 1998–2006 and acted as the main sponsors in 40 percent of projects. Much of this investment was in telecommunications (where local investors contributed 63 percent) and transport (58 percent).

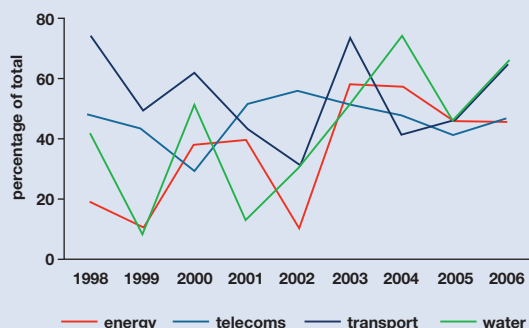
In Sub-Saharan Africa developing country investors accounted for 50 percent of private investment. Much of this (58 percent) came from private investors in South Africa alone.

Latin America and the Caribbean had the most private investment in infrastructure during 1998–2006—accounting for 42 percent of the developing world's total—so its results are strongly reflected in the global picture.⁷ Developing country investors were the main sponsors of projects as often as developed country investors were, but the latter accounted for 56 percent of investment commitments during 1998–2006.

Developed country investors dominated in Eastern Europe and Central Asia, with 73 percent of investment commitments, reflecting in large part the proximity and interest of Western European companies. But these commitments went to only 39 percent of projects. In transport, local firms play a significant role measured not only by the number of projects in which they participate, but

FIGURE 3**Mixed trends across sectors**

Developing country investors' share of private investment commitments to developing country infrastructure projects by sector, 1998–2006



Source: Ettinger and others 2005, updated to include years up to 2006.

Local investors are most active in South and East Asia

also as providers of investment capital, accounting for 44 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. In the water sector all investment commitments came from developed country investors.

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 policy makers 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.⁸ 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 (<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 2006 U.S. dollars.
2. 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.
3. Examples here are from Harris (2003), updated to take account of recent changes.
4. The study, which drew on the PPI Project Database, chose 1998 as the starting point mainly because of data limitations relating to the investments committed during 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; annual investment flows peaked in 1997 and then fell sharply as several factors led to a reduction in both the size and the number of projects.
5. *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).
6. The calculation of investment shares assumes that each investor accounts for a share in total investment that is equal to its share in equity.
7. Latin America and the Caribbean also had the sharpest drop in private investment: in 2006 investment was only 35 percent of that in 1998, while for other regions it surpassed the 1998 level.
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.

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