THE SUBCONTINENT STIRS

Set to become the world's third largest economy by 2050, India's demand for housing, infrastructure, and commercial property is vast and growing. By 2012, the government plans to spend US$300bn on infrastructure alone. **David Smith** examines how the need for top-end professional services on the subcontinent could mean opportunities for foreign firms

This is residential development, Indian-style: 217 new townships across the continent, each boasting a hospital and schools, plus water, gas, power and transport infrastructure in the same class as a first-tier "Metro" city.

India is building on a scale that is alien to all other countries, with the obvious exception of China.

The audit firm PricewaterhouseCoopers (PwC) said in a recent report that India would become the world's third largest economy by 2050, adding that its annual growth should continue at about 7.5% despite the global recession.

India's construction industry is worth over US$51 billion a year and the Government wants US$300 billion invested in infrastructure by 2012 to take advantage of its huge natural resources and industrial potential. It also plans to build millions of homes, a necessity because its population is around 1.17 billion and is expanding at around 1.5 % a year.

India is so vast and complex that any generalisations are half-truths at best, but for the most part it has the skilled and unskilled labour it needs. What it more often lacks are the high-end skills to carry through its visions. Therein lie some of the best opportunities for foreign firms.

Take the project to build 217 townships. The Indian firm Sahara can martial the manpower to construct them, but is realistic enough to know it doesn't have the project management skills to oversee such a massive, far-flung affair. So it has hired Gleeds, the 130-year-old British management and cost consultant.

"Gleeds couldn't put 217 townships together, though they do provide a perfect partner for Sahara," said Kevin McCole of the UK India Business Council (UKIBC). "Sahara can provide the scale and get access to Indian finance in a structured, phased way. And Gleeds brings to the table its experience of high-level project management.

TEMPTING FROM THE OUTSIDE

"If something is straightforward and simple, British companies can't compete with Indian firms on price," McCole added. "They need to look at the more sophisticated, higher end, where there are real opportunities. India often lacks the skills needed to provide sustainable buildings, high-end engineering and architecture, and the complex management of projects."

The experience of Mott MacDonald on the ground in India illustrates a second important lesson for foreign firms – that local knowledge is an invaluable asset in understanding a complex, ever-changing, often alien culture.

Although UK-owned, Mott MacDonald has offices all over India. It is involved in a number of projects, including helping to build an airport at Sikkim in the Himalayas and working on the metro systems in Delhi, Bangalore and Calcutta. Of its 1,400 staff, only eight are ex-pats. The rest are Indians.

Shiva Acharya, Mott MacDonald's business development director in India, said: "Foreign companies can see India's huge growth and it looks very attractive. However, you really need to be based here – as we are – to understand all the barriers to entry. It can look tempting from the outside, but when you come in you can soon lose heart if you don't get this or that approval, or you get tied into contracts which only pay small sums up front and mess up your cash flow.

"Companies without an Indian base need to weigh up the opportunities carefully. What exactly is it? Who is the client? What are the contractual terms? It's usually best to team up with Indian companies, or at least foreign companies with strong bases in India, because they know the market well and can negotiate the best contractual terms."

Mott MacDonald has been especially cautious about taking on highways work. The unwieldy nature of projects which span different states, unethical practices, and frequent delays, have often made such work unattractive.

"It's true that we've been reluctant to get involved with highways work because of the contractual terms, but with the new Prime Minister getting involved now a lot has changed. Highways investment will go up and it will be easier for contractors like us to work. For years, there was a big cashflow problem and we obviously believe in looking at a return on the capital employed.

"But again that is a generalisation about highways. There are good contracts out there. My advice is not to work for everybody as some companies work more ethically than others. And to be cautious about working in some states as India is a federal country and some states work

BRITISH COMPANIES CAN'T COMPETE WITH INDIAN FIRMS ON PRICE

far more efficiently."

Expansion of the highways is a vital part of India's infrastructure plans. The Highway Authority plans to add 50,000 km to the road network by 2015, requiring US$42 billion investment over three years.

But another word of caution to foreign companies salivating at the scale of activity there came in a major report from the World Bank, which cast doubt on India's capacity to carry out its road plans. The Bank warned that there would be a 55%-to-64% shortfall of skilled resources over the next eight years. The number of civil engineering graduates and diploma holders would need to treble to meet demand, it said in *India's Road Construction Industry: Capacity Issues, Constraints and Recommendations.*

The study contrasted India's plight with »

MAJOR PROJECTS PLANNED FOR THE NEXT FIVE YEARS IN THE PUBLIC AND PRIVATE SECTORS

- Dedicated freight corridors between Mumbai, Delhi, Ludhiana and Kolkatta
- Reliance SEZ Navi Mumbai
- Mundra SEZ in Gujarat
- Urban Metro systems in Chennai, Bangalore and Hyderabad (below)

- Modernisation and renovation of four Metro airports and 35 smaller airports
- The six-laning of over 6,000 km of roads under the Golden Quadrilateral programme
- Extensive port development through public-private partnerships in Kerala, Tamil Nadu and Andhra Pradesh, Gujarat and Maharashtra
- Mumbai Trans Harbour Link Project that stretches 22km and will link the harbour hinterlands

- Chennai Port Container Terminal (above) with an annual capacity of four million TEUs, is likely to become operational by 2012-2013.

SOURCE: UKTI

» China's superior logistical planning. India has around 110,000 highway engineers, whereas the Chinese road infrastructure development from 1989 to 1997 was supported by over 500,000 trained highway engineers.

"Industry has not kept pace with the growth in the number of projects in India, which means that funds allocated to road projects often go unused," the report said. "There are still perennial time and cost overruns on both state and national highway projects."

The World Bank's harsh wake-up call to India did not end there. It said that while the outer limit of time extension for contracts in the UK was 25%, in India 70% of contracts exceeded that limit, often by large margins. In addition, 40% of contracts in India experienced cost overruns of 25-50%.

The study makes key recommendations aimed at improving overall efficiency (see box). These include advice on institutional structures and regulation, project design, quality of human resources, access to finance and efficiency in procurement.

NOW WE HAVE A STABLE GOVERNMENT WHICH WILL LAST FOR FIVE YEARS

The study did acknowledge, however, that the Indian government is addressing the problems.

"While the capacity challenges in the industry are huge, certain recent initiatives taken by the Government of India in improving the investment climate are very encouraging," said Arnab Bandyopadhyay, senior transport engineer of the World Bank and co-author of the study. "Notable among these initiatives, fully coherent with the study recommendations, are decisions to undertake the international road shows and review the current Model Concession Agreement for National Highway projects."

Bandyopadhya's note of optimism is justified by the Indian government's policy interventions, which are transforming a sector frequently dubbed "unorganised".

For example, the government now allows foreign direct investment (FDI) of up to 100% in townships, infrastructure and construction projects, including housing and commercial property.

"The liberalisation process is changing the nature of the game," said Ranveer Sharma, a principal at Eredene Capital, which invests in India. "There is much less bureaucracy than there used to be. Over the last 10 years all sectors have been liberalised. The process began in 1991 when the current Prime Minister, Dr Manmohan Singh, was the finance minister. He was very much the driver behind Indian globalisation. Up to that point, the government was the sole owner and developer of all assets.

"In May this year, Dr Singh returned as Prime Minister, which was a very positive step for India. Now we have a stable government which will last for five years with a majority in parliament. It sees infrastructure as a priority and a lot of sectors will be looked on favourably. We will see a lot more investment and there will also be lots of financial and fiscal incentives for foreigners."

He added: "Before the election we had a Government comprising of more than 12 political parties. There was no common agenda. The new government has a vision for India which has given us far more hope than any government in the past."

FUNDS GRATEFULLY RECEIVED

One key way the Indian government is seeking to encourage overseas investment is through Public Private Partnerships (PPPs).

PwC's recent report had this to say about PPPs. "The policies seek to encourage investments in domestic infrastructure from both local and foreign private sources. Public Private Partnerships are gaining in importance, and are benefiting from government support – targeted PPP participation is US$150 billion."

The PPP model has already demonstrated its global appeal. International interest in Indian PPPs soared in 2008. A number of contractors from Europe, Australia, China, Malaysia and Korea have already made their presence felt, including Toyo Engineering, Jacobs H&G, Uhde, Tecnimont, and Aker Kvaerner.

The PPP model is especially attractive to British companies. "One of the ways we are trying to open up opportunities for contractors is in working with the Indian government to draw up PPP models which the UK contractors are familiar and comfortable with," said the UKIBC's McCole. "It takes away one of their concerns when bidding for jobs."

Martin Harman, a lawyer with law firm Pinsent Masons, who has decades of experience advising on Indian infrastructure projects, works with the Indian government on developing PPPs.

He agrees that the PPP system helps overseas companies to get a foothold in India, but he also sees advantages for British firms over foreign rivals in drawing up contracts. "The Indian system is also a common-law legal system. Lots of firms – such as Mott Macdonald – are out there in India producing contracts which are very similar to English ones."

Harman is another preacher of prudence to firms entering India. However, he believes the right contracts can be negotiated by careful practitioners.

"Contracts have traditionally been one-sided in favour of owners and lacked an alliance style of approach, but there are ways around the difficulties. The first thing to do when drawing up a contract is to make sure it's structured properly and that the rights and obligations of both parties are clearly set out. It's illegal for UK lawyers to practice in India, but they can help by getting in touch with the right Indian law firm and by guiding the Indian lawyers about the sensitivities of the UK market," he said.

Having urged caution, and spoken about the difficulties of entering the Indian market, it's only fair to say that many foreign companies are thriving there. The success of private-sector Indian companies has also made it easier to enter the market. India is changing and becoming more accessible.

"A lot of contracts previously were public sector contracts so it was harder for UK companies to access opportunities by bidding from overseas. Now you've got big Indian players from the private sector – like Sahara – succeeding. They know how to navigate the system and foreign firms can often enter the Indian market on the back of their expertise," said McCole.

Some of the most successful Indian players are Afcons, IVRCL, Nagarjuna Constructions, Hindustan Construction, GMR and GVK Constructions, Unitech, DLF, Sobha Developers, Hiranandani and Raheja. Most have grown rapidly. Notable foreign presences include Emaar Properties, American International Group, the UK's High Point Rendel, Edaw-US, Japan's Kikken Sekkel, Lee Kim Tah Holdings and Cesma International from Singapore.

The widespread perception is that the growing sophistication in the construction industry has created new opportunities for foreign companies in design, structural engineering, project management and high-end construction products.

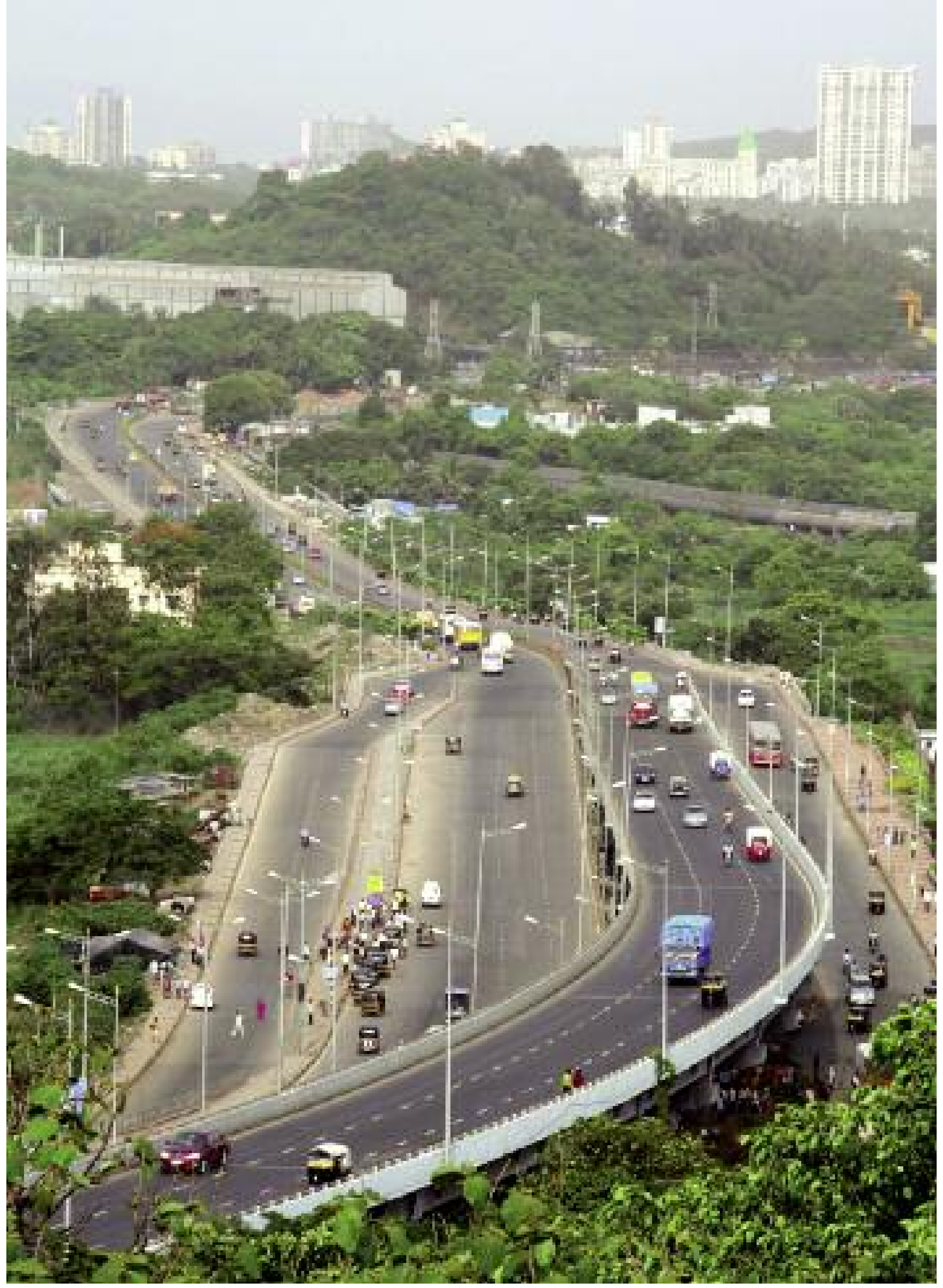
A UKTI spokesman said: "British companies which have tried to do business with India in the past are amazed at how quickly things have changed since they were last here. Private sector opportunities, which would have been unthinkable 20 years ago, are now embedded realities.

"In a diverse market like India, it is important to have the right market strategy. It is often very difficult, or costly to retract if wrong decisions are made. This can also have long-term and damaging reputational implications which can harm longer-term prospects. This is particularly true in the construction sector which tends to require overseas companies to have a longer-term presence before business is won."

So, where are these new opportunities? Let us consider which sectors might prove attractive to foreign firms with the right approach and skills.

The housing sector is throwing up huge opportunities. A booming population, higher incomes, rapid urbanisation, and affordable interest rates are driving growth. According to a research study, India will need 25 million dwelling units by 2015, requiring over £10 billion in investment.

Linked to the housing boom, is the increasing demand for commercial property development to meet the needs of business. This is especially true of the IT and ITES sector – ITES stands for IT enabled services, such as outsourced call centres – which has seen annual growth rates of over 25%. Against global trends, the sector posted a growth rate of 12% in FY 2009 with the aggregate revenue touching nearly US$72 billion. As a result, India needs over 300 million sq ft of office space in the next few years.



One of the new highways in Mumbai

The infrastructure sector has moved rapidly in the last four years, but has a long way to go. According to the 11th Five Year plan, India needs more than US$300 billion for infrastructure projects. The Government plans to source these funds from combinations of Public-Private Partnerships (PPP), public investments and exclusive private investments.

IN THE SPECIAL ECONOMIC ZONE

The Committee on Infrastructure, which is headed by Prime Minister Singh, gave estimates of investment figures for different sectors by 2012: They predicted $42 billion for roads, $59 billion for railways ($24 billion through Private Partnerships), $7.8 billion for airports and $9.8 billion for ports.

As mentioned, the Highways Authority has major plans to make up the shortfall in the road network, which spans over 3 million kms but has a road density at 2.75 km/1000 which is much lower than the global average of 6.7 km/1000. With a view to attracting foreign investors, the Ministry of Road Transport will hold international "road shows" in Asia, Europe and the USA.

The market for green building materials and products is expected to touch over $3.3 billion by 2010. From a mere 20,000 sq ft in 2003, India has over 25 million sq ft of green floorspace. By 2012, the area under green buildings is estimated to be 1 billion sq ft. This represents a major opportunity for foreign firms who often possess an expertise in constructing sustainable developments, which is rare in India.

A further development is the Special Economic Zones, designated as duty-free enclaves for export production. So far, 578 SEZs have been approved, representing an area for development of over 35,000 ha. The Ministry of Commerce will invest around $46 billion in SEZs by the end of this year.

Products such as cement and tiles, which are dependent on the construction sector, are seeing growth of around 13% per year. Other products like steel and glass have been growing between 7-10% annually, and paint at over 10%.

Only well-established players tend to adopt safety practices, which means there will be huge scope to sell safety equipment and advanced construction technology as working methods change. Workers will also have to be trained to use the new technology, and in how to implement safety standards.

Construction equipment is another segment which is a major beneficiary of growth. The market is estimated to be 20,000 units by volume and £3.7 billion by volume. The equipment market is growing at 35-40% Year on Year (YoY). Critical equipment will be in demand as for roads, airports, engineering projects, power and residential and commercial construction in the coming years. Equipment makers will find their products in demand if they are adapted to suit Indian conditions and at competitive prices.

British company JCB already has a massive foothold in the Indian market. Around one in two diggers in India carries the JCB insignia. Since most of the users are minimally literate, training in using high-end equipment is also a major opportunity.

For all the advice about discretion, there is no doubt that the Indian market is a far more attractive proposition than it once was. "A lot of contracts previously were public sector contracts so it was harder for British companies to understand and penetrate the market," said the UKIBC's McCole.

"Now that the big private-sector Indian players are operating in a liberalised economy with the know-how to navigate the system, it has made it easier for foreign players to get into the market.

"It is more the non-tariff barriers that we need to look at dismantling. They are still putting off a lot of UK companies. A lot of the unwillingness is caused by a lack of awareness of good opportunities."

To break down barriers, The UKIBC is setting up a UK-India business forum.

"The idea is to let firms know what's going on, but more importantly to help them learn how to do business in India. The British companies who have learned the hard way and succeeded in India, like JCB, or Arup, can share their experiences with less experienced companies. One of the key lessons will be how to find the right partner.

"Indian infrastructure companies are keen to partner UK firms. It's often a matter of putting them in the same room and letting them get on with it." *icon*

THINGS TO DO: HOW THE WORLD BANK WOULD IMPROVE INDIA'S CONSTRUCTION INDUSTRY

- Streamline the pre-construction process and clearances regime;
- Set up a Road Appellate Tribunal for faster dispute resolution based on the US and Singapore models, rather than the current contract-by-contract approach;
- Initiate a system for rating, grading and registration of construction companies and individuals, as currently done in the US and several European countries, to improve professionalisation in the industry and to facilitate improved access to finance;
- Frame a construction law to improve the legal and regulatory environment in the country.