

**Project Simest-Assocamerestero  
“Business Scouting & Assistance to Italian SMEs”**

**OPPORTUNITIES FOR ITALIAN SMEs IN THE INDIAN CONSTRUCTION AND  
BUILDING SECTOR**

***The market and the opportunities***

The Indian Government considers the country's infrastructure development as a priority and the estimated investment requirement in this sector for the period 2012-17 is € 750 billion. Excluding the investments reserved for the energy sector, the total Indian requirement in the infrastructure and building sector is split up as follows:

- *Roads and highways, € 65 billion* – highways constitute 1.7% of India's entire road network, but they carry 40% of the national road traffic. It is intended to build and/or extend 18,500 km of highways.
- *Urban construction and infrastructure, € 400 billion* – growth of the requirement due to the constant increase in the population especially in the 7 major urban areas (Mumbai, Delhi, Bangalore, Hyderabad, Ahmedabad, Chennai and Calcutta):
  - Housing: 300,000 units required
  - Commercial space: 3 million m<sup>2</sup>
  - Retail: 200,000 m<sup>2</sup>
  - Hospitality: 100,000 rooms
  - Hospitals: 900,000 beds
  - Special economic zones: around 600 projects approved
  - “Greenfield” construction of around 400 new cities with more than 1 million residents
- *Airports, € 25 billion* – The number of airports grew from 50 in 2000 to 136 in 2012. Investments for the construction of 10 new airports (for a total of € 10 billion) and the upgrading of existing ones (€ 15 billion)

Till 2005 investments in infrastructure development were around 4% of the GDP. Since 2005 this rate is linked by ministerial decree to GDP growth (8% in 2011-12, 5.5% estimated for 2012-13).

Today the sector accounts for 27% of the country's industrial production, but it has a number of limitations that hamper its regular and harmonious development:

***Market:***

- Absence of an organised supply chain;
- Low inclination to spend and high price consciousness;
- Inadequate improvement of product quality, especially for high value-added services (design, planning, quality control, etc.);
- Low productivity because of low quality and non-specialised labour

***Tenders:***

- Substantial use of discretionary powers in drafting tenders (land acquisition, environmental clearances, procurement procedures) and in awarding the same;
- Absence of a regulatory system for the application of quality standards;

- Procedures that are still highly complex, not oriented towards improvement of quality but towards optimisation of costs;
- Dispute settlement procedures not always transparent and not compliant with international standards of arbitration

*Project financing:*

- Dominated by state banks, not inclined to grant long-term finance especially to foreign private investors;
- Many contractors have adopted very aggressive financial policies and are now unable to submit new tenders. They are now looking for partnerships with foreign contractors.

However there is a great demand for advanced technology as well as for engineering and consultancy services in the following segments:

*Construction machinery*

- Underground engineering: pile and tunnel machinery
- Earth moving equipment, especially crawler excavators (requirement of 23,500 units by 2016), mobile cranes (3,500 units), wheeled loaders and mobile compressors (2,400 units each);
- Lightweight equipment for concrete making and for prefab products

*Transport*

- ITS (Intelligent Transport Systems) for road and rail traffic management (Mass Rapid Transit Systems and Light Rail Transit)
- Electric vehicles
- Satellite navigation systems
- Maintenance, repair and overhaul services (MRO)

*Residential buildings (townships and quality residential complexes), office districts and shopping centres*

- Elevators and lifts
- Air-conditioning systems and "housing automation" plants
- Urban planning and design services

*Building materials*

- Prefab items made of cement and steel
- Prefab components and products made of concrete
- Insulating and waterproofing materials and systems
- Marble, tiles, coatings and finishing materials
- Adhesives and paints
- Doors and windows

***Regulations and developmental policies***

Indian regulations are progressively opening up to the market: from the liberal reforms of the '90s, Indian policies have opened up the entry of the private sector into the country's infrastructure development and have removed in many sectors the need for foreign investors to procure a licence to operate in the Indian market. In the last few years import duties have been progressively reduced, especially of high-tech goods and machinery.

## Roads

- 100% FDI allowed
- 100% tax exemption in road projects for 5 years and 30% for the next 5 years.
- The companies are assured a capital up to 40% of the total project cost to improve the viability

## Airports

- Till the '90s, the Airports Authority of India (AAI) was the only public body in charge of airport construction and management. Today, there are 5 big groups that participate in the development of the sector (see enclosure)
- Up to 100% FDI allowed, subject to clearance by the Foreign Investments Promotion Board (FIPB), for brownfield investments
- Up to 100% FDI for greenfield projects through the automatic channel (clearance by the Foreign Investments Promotion Board is not necessary, but only a letter ex-post to the Reserve Bank of India)
- Total tax exemption for 10 years

## Urban infrastructure

- Up to 100% FDI allowed, subject to clearance by the FIPB, for the development of municipalities and urban settlements
- Up to 100% FDI allowed in the hotel and tourism sector, through the automatic channel
- Total FDI in the real estate sector during the period 2000-10 amounting to over € 8 billion
- The real estate and construction sector currently accounts for over 22% of the total FDI (it was less than 4% in 2006)
- 110 collaboration agreements between foreign and Indian companies from 2001 to the first half of 2011

## Public-Private Partnership (PPP)

In PPP projects, normally the Indian government bears the costs of conducting the project feasibility study, purchase of land, shifting of utilities, environmental clearances, cutting of trees, etc. Moreover, the private partner can avail of:

- Subsidies up to 40% of the cost for making the projects feasible
- 100% tax exemption on the toll revenue, after the commissioning of the project, for 10 up to 20 years
- Import of equipment and technology necessary for road construction exempt from duty
- Regulatory simplification for foreign loans
- Right to retain the toll proceeds, which are indexed on the market prices

PPPs assume different forms. The most common ones are:

1. Build Operate and Transfer (BOT) with the provision of tolls – the private concessionaire bears the construction and annual maintenance costs and recovers the investment, with interest, through the tolls collected. To bridge the gap between the investment necessary and the profit obtained from the same, while increasing the profitability of the projects, a government capital grant is provided for (up to 40% of the project cost).
2. Build Operate and Transfer (BOT) on an annual basis: the concessionaire bears the construction and annual maintenance costs and recovers the investment from the client with a

sum fixed a priori, regardless of the tolls collected annually by the client. The concessionaire is selected based on the lowest annual repayment proposed in a time period fixed beforehand by the bidders.

3. Special Purpose Vehicle (SPV), independent companies set up through the issuing of bonds. The investment is recovered in the prescribed concession period, through the collection of tolls, by the SPV.

The execution of projects in public-private partnership (PPP) has the following benefits:

- Better quality as the concessionaire (private sector) is responsible for maintaining the road for the concession period.
- Completion of the project in a short time, since the concessionaire could reduce the interest and immediately collect the tolls (in case of a BOT project with tolls) or get further returns (in case of annual BOTs)
- No overshooting of the estimated initial costs
- The client (Government / NHAI) does not have the task of maintaining the highways (this is not a benefit for the private party but rather a cost)

Against the potential benefits, the risks to the investor/private operator must also be pointed out:

- Traffic volume studies that constitute the input for determining the revenue from the toll are provided directly by the client NHAI and therefore the operator cannot – in the time limit given for preparing the tender – perform an accurate check of the underlying assumptions and hence of the reliability of this information crucial for the tender;
- The procedures for eligibility of the suppliers of building materials (ex.: concrete, bituminous mixtures, etc.) do not provide stringent criteria either for the reliability of the suppliers or for the product delivered on-site. The risk is that the materials supply contract is awarded to the lowest bidder and that therefore the quality of the material delivered is inferior with consequent increase in the maintenance costs borne by the private partner;
- The timeframe for the settlement of disputes following expropriation of land may be longer than the stated timeframe with consequent impact on the reaching of the break even time.

### **Schemes and criteria for eligibility of suppliers**

India has only recently started introducing some policies and initiatives to improve the quality, sustainability and safety of construction and infrastructure.

For the moment the initiatives are mainly voluntary in nature and are not yet legally binding.

Among these can be cited the *certification scheme for concrete plants* promoted by QCI (Quality Council of India) and BMTPC (Building Materials and Technology Promotion Council). The scheme provides for two levels:

1. Basic (focused mainly on requirements in compliance with Indian standards for the production of concrete) and
2. RMC 9001 Plus (based on the integration between the requirements of the ISO 9001 standard and those of the Basic scheme).

## **Investment procedures and presence of Italian companies**

The strategies for entering the market of infrastructure, construction and building products and energy, change considerably based on the type of product or service offered.

In the infrastructure sector, particularly for companies involved in road construction, the entry strategies can vary based on the activity carried out by the company. However, 3 main entry procedures can be identified:

1. Setting up of a Joint Venture with a local partner that generally provides labour and infrastructure (production, warehouses, logistics) and the foreign partner, that provides the know-how and project management.
  - a. This JV is sometimes limited to the execution of one project, which enables the Italian company to get a preliminary field experience and assess developments in the market. This is the case of Atlantia, which set up a JV with the Tata group for the construction of a stretch of highway in the state of Maharashtra.
  - b. More often, the JV has a broader strategic perspective: in 1992 Fiori Spa signed a JV with the Indian company Ajax (Ajax Fiori Engineering) for the production of construction machinery (concrete mixers and concrete mixing stations)
2. Setting up of a local subsidiary, through which the company (normally large-sized):
  - a. participates directly in the tenders. This is the case of Ansaldo STS, which has been working closely with Indian Railways since 1987 for the design and execution of new technologies to improve the safety and efficiency of Indian urban and suburban railway lines;
  - b. directly supervises all the phases of the project, from design to implementation. This solution was chosen by some Italian design companies, for example Tecnimont Maire, FG Tecnopolo and Progetto CMR, by specialised certifying bodies like ICMQ, and by companies involved in large infrastructure projects like Soilmec (vertical drilling), Pama (horizontal drilling), Maccaferri (waterproofing fabrics);
  - c. develops the local market, like in the case of Italcementi (that acquired the shares of Zuari Cements), Kerakoll (in India since 2010 with executive office in Mumbai and logistics centres in Bangalore and Salem), Mapei (present from 2011 in Bangalore).
3. Setting up of a local branch office, which does not operate business transactions but identifies clients (manufacturers or main contractors) to whom to provide subcontract services directly from Italy. This is the case of the Wegh Group, operating in the design and manufacture of prefabricated products and plants in the railway sector.

The Indian infrastructure and construction market has, on the one hand, enormous potential but, on the other, considerable difficulties of entry.

In India more than elsewhere, the market entry strategy cannot be based merely on the individual initiative of the single company, but requires maximum liaising with all the Italian institutions present in the country.

For this reason the Indo-Italian Chamber of Commerce promoted the setting up of the Indo-Italian Club for Infrastructure and Building (IICIB) with the aim of offering to Italian companies operating in the various segments along the construction supply chain (from architecture to engineering, from construction to building materials, machinery and equipment) a reference point to provide information and services to those who wish to enter the Indian market.

The mission of IICIB is to encourage and support cooperation between Italian and Indian companies in the construction and infrastructure sector through services of partner scouting, market studies, organisation of meetings, information on tenders, etc.

Italian and Indian companies are present in the Club. Not all of the Italian companies have a presence in India, but they decided to join the Club to plan their entry strategy in a better manner.

In 2011 IICIB promoted an ambitious system project in which to concentrate the resources available in Italy and in India to promote the entire Italian construction and infrastructure supply chain.

The project was promoted jointly by IICCI and by Confindustria, supported by the Ministry of Economic Development and by the Italian Embassy in Delhi with the involvement of a group of Italian companies.

The project is called LEGEM ([www.legemcity.com/](http://www.legemcity.com/)), an acronym of Living Space, Energy, Governance, Environment and Mobility, and intends to create in India an alternative urban development model to the one currently dominant in Asia (based on the idea of Megacities), more focused on man, sustainability and liveability and based on the Italian landmarks operating along the entire construction supply chain.

LEGEM is an example of a new approach to the process of internationalisation of our economy firmly based on a strong interaction among institutions, associations and companies.

**Enclosure 1 – Indian companies participating in airports development projects**

Company	URL	Airport	Description
<b>GMR Infrastructure</b>	<a href="http://www.gmrgroup.in">www.gmrgroup.in</a>	Development of Hyderabad International Airport. Modernisation of Delhi International Airport.	GMR Group is a Bangalore headquartered global infrastructure major with interests in the Airports, Energy, Highways and Urban infrastructure.
<b>GVK</b>	<a href="http://www.gvk.com">www.gvk.com</a>	Modernisation of Mumbai International Airport.	GVK is a leading Indian conglomerate with diversified interests across various sectors including energy, resources, airports, transportation, and hospitality
<b>Siemens</b>	<a href="http://www.siemens.co.in">www.siemens.co.in</a>	Development of Bengaluru International Airport.	The Siemens Group in India supplies technology enabled solutions operating in the core business segments of Industry, Energy, Healthcare, Infrastructure.
<b>L&amp;T</b>	<a href="http://www.larsentoubro.com">www.larsentoubro.com</a>	Development of Bengaluru International Airport.	Larsen & Toubro Limited (L&T) is a technology, engineering, construction and manufacturing company. It is one of the largest and most respected companies in India's private sector.
<b>MAYTAS Infra</b>	<a href="http://www.MaytasInfra.com">www.MaytasInfra.com</a>	Development of Simoga and Gulbarga Airports in Karnataka.	Maytas Infra Limited is one of the leading Infrastructure Development, Construction and Project Management Companies in India with more than two decades of rich and varied experience in execution of landmark projects across the length and breadth of the Country.