PRIVATE SECTOR ASSESSMENT (SUMMARY)\(^1\)

1. **Sector Performance, Key Issues, and Constraints**

1. India’s private sector has been the major engine of growth and employment generation during the 1990s and 2000s. Its contribution to gross domestic product (GDP) growth has increased from around 66% in the 1980s and 1990s to more than 80% in the 2000s. Its share in overall employment has been consistently more than 90% since the 1980s. It has also been the main driver of investment in India and contributes more than 75% of domestic capital formation.

2. India’s private sector includes agriculture, which is entirely dependent on private farmers, most of whom have modest land holdings; small and medium-sized entrepreneurs in industry and services; and larger domestic corporate entities, many of which have become major global entities. The continued dynamism of the private sector and its ability to seize economic opportunities is vital for inclusive growth, as the bulk of future jobs will be created in this sector.

3. Liberalization of international trade, industrial deregulation, tax reforms, and privatization of certain public sector industries have significantly contributed to India’s rapid growth in the 1990s and 2000s. Despite this surge, investment and industrial output continue to be lower than in comparable Asian countries.\(^2\) This results from several structural bottlenecks that have constrained private sector operations and impaired the investment climate, including (i) the absence of quality infrastructure; (ii) burdensome regulations governing the entry, operations and exit of firms; and (iii) delays in land acquisition. These have increased the difficulty of doing business in India.\(^3\)

4. The absence of quality infrastructure has prevented India’s private sector from realizing its potential. Ports working beyond capacity result in extremely long turnaround times, while roads suffering from congestion lead to delays and heightened costs. The unreliable and inadequate power supply also significantly increases the cost of production. Moreover, micro-, small and medium-sized enterprises (MSMEs) experience disproportionately higher transaction costs, because unlike large firms they are unable to create customized alternatives such as private access roads and captive power plants. Agriculture continues to suffer high post-harvest losses, particularly in horticulture, livestock, and fisheries. Large investments are required to create warehouse capacity, cold storage, and supply chains. Furthermore, improving agricultural productivity will be critically dependent on enhancing investment in irrigation and water-saving devices.

5. Financing the economy’s infrastructure needs will require greater outlays from the public sector and a more-than-proportionate increase in private investment. The private sector’s share of the $1 trillion infrastructure financing requirement over the term of India’s Twelfth Five Year Plan (2012–2017) is envisaged to be about 48%. However, the complex and capital intensive nature of these projects, long gestation period, and multiple risks to project financiers, including those arising from socio-political issues, makes financing a difficult challenge.

---

1 The full Private Sector Assessment report is available upon request.
6. At the same time, the financial sector faces a number of challenges in providing adequate finance. Commercial banks, which have been the most prominent financier of infrastructure, are already reaching their lending exposure limits for the infrastructure sector and face problems of risk concentration and asset–liability mismatches. From the point of view of such mismatches, insurance and pension funds are ideally suited to invest in infrastructure as they leverage long-term liabilities. However, they are constrained by their obligations to invest in government securities and the statutory requirement to invest only in assets graded AA or above. The corporate bond market remains at a nascent stage of development due to the absence of a robust bankruptcy law, limited investor base and limited number of issuers.

7. The private sector is also constrained by the multiple regulations governing the entry, exit, and operations of firms. These pose an enormous compliance burden—especially on MSMEs that have limited resources—discouraging entrepreneurial talent and reducing jobs. Moreover, regulations such as price preference and mandatory purchases have distorted incentives to scale up and improve productivity. Multiple land acquisition policies, and variations in rules on how land can be acquired and compensation paid to the land sellers have added to the complexity of doing business. Securing environmental clearances for new projects has also been a key roadblock for investors. Similarly, in agriculture and related activities, stock controls and export restrictions deter private participation in many crops. Limited progress on reforming the Agriculture Produce Marketing Committee Act has delayed establishment of private market yards, direct buying and selling, and contract farming in high-value agriculture, making it difficult for private companies to strategize procurement and storage.

8. Small and marginal farmers as well as MSMEs are constrained by their limited ability to access finance from banks and other financial institutions because they lack adequate credit histories or collateral. A significant shortage of skilled human resources is another key challenge for the Indian private sector. Since mid-2000s, the government’s flagship programs have brought India closer to the target of universal primary education, but greater investment is required in technical and vocational education to meet the skill deficit. Moreover, to ensure that skills match demand, employers and enterprises must play an integral role in conceiving and implementing vocational training programs.

2. Government Strategy

9. Infrastructure investment as a share of GDP is targeted to increase from an average of 7.2% during FY2007–FY2012 to about 9% by the end of the current plan (FY2016) to alleviate the various infrastructure-related constraints, with a significant contribution from the private sector in electricity, renewable energy, roads and bridges, telecommunications, urban transport, ports, airports, and storage. To promote private sector investment in infrastructure, the government has initiated (i) the establishment of a robust institutional structure for appraising and approving private–public partnership (PPP) projects, (ii) the development of standardized documents such as model concession agreements across infrastructure sectors, and (iii) increased availability of finance by creating dedicated institutions and providing viability gap funding. The government is also increasingly focusing on improving governance of ongoing PPPs, especially in areas such as PPP administration, arbitration, conflict resolution, and termination.

4 The National Manufacturing Policy 2011 highlights that on average, manufacturing units need to comply with nearly 70 regulations, which lead to multiple inspections, and filing of over 100 returns in a year.
10. The National Manufacturing Policy, 2011 seeks to reduce the compliance burden on industry arising out of procedural and regulatory formalities by rationalizing business regulations. Initiatives proposed include single-window clearances, web-enabled services for various state and central clearances, and replacement of multiple returns with a simplified monthly or quarterly return. To remedy deficiencies in the existing legislation for land acquisition, which dates to the colonial era, the government has introduced the Land Acquisition Relief and Rehabilitation Bill in Parliament, which is expected to create a more balanced framework protecting the rights of those whose land is being acquired, as well as those whose livelihood will be disrupted.

11. The Twelfth Five Year Plan aims to improve the access of credit-constrained firms and farmers through the use of a banking correspondents model (taking advantage of existing mobile and information technology), complemented by additional bank branches and post offices to improve access to banking and insurance services. To strengthen India’s human capital by enhancing the employability of its youth and work force, the government launched two flagship programs in 2009: (i) the National Skill Development Mission, which aims to provide at least 50 million individuals with marketable skills by 2017; and (ii) the Rashtriya Madhyamik Shiksha Abhiyan (National Secondary Education Mission), which aims to provide universal access to secondary education by 2017, and achieve universal retention by 2020. Employers and enterprises are expected to be integrally involved role in developing the vocational training programs.

3. Asian Development Bank (ADB) Sector Experience and Strategic Directions for Assistance Program

12. ADB has contributed to the mobilization of private capital, creating opportunities and enabling a sound business environment for the private sector through technical assistance (TA) and financial support to the government, and public and private entities. Under Strategy 2020, ADB is committed to expanding its work with the private sector to promote economic expansion in the region. To that end, it aims to scale up private sector development and private sector operations to 50% of annual operations by 2020. ADB’s private sector operations will support the new country partnership strategy (CPS) along the strategic directions listed below. Intended private sector operations programs are integrated into each public sector road map in this CPS.

13. Financing sovereign infrastructure projects. ADB will continue to support investment in infrastructure, because the lack of quality infrastructure constitutes a major impediment to private sector growth. ADB will focus on strengthening power transmission and distribution networks, providing metering and systems to reduce technical and commercial losses and improve the financial health of power distribution companies, as well as low-carbon initiatives, including renewable energy. ADB will also support investment to improve water resource management for better irrigation. Support to rural road development through Pradhan Mantri Gram Sadak Yojana will continue, while support to state road development will be expanded. Furthermore, ADB will continue its support to railway development and focus on providing greater access to less-developed regions. Urban sector development will be supported through investment in sanitation, urban health, and urban transport among other infrastructure development initiatives. ADB will assist regional connectivity initiatives as well as connectivity along economic corridors that link major domestic centers of production and exchange with emerging centers of production and employment. The latter will be complemented by

---

concentrating resources in selected urban centers, especially those that serve as vital nodal points along high-potential economic corridors.

14. **Nonsovereign operations.** ADB’s private sector infrastructure operations in India have been concentrated in the financial and infrastructure sector, and this will largely continue. ADB is looking to support selective infrastructure transactions, particularly in renewable energy, urban transport, water, waste management, roads, ports, agriculture, housing, and education. In the financial sector, ADB will explore support to banks and nonbanking financial institutions for microfinance, renewable energy, priority sector lending such as lending to small and medium-sized enterprises, education, and agriculture, and assist them in meeting capital needs under the Basel III requirement. Nonsovereign operations are dynamic and driven by demand from the private sector. Recognizing the diverse needs of India’s large economy, ADB will also selectively diversify into other areas to meet national and private sector development needs.

15. **Innovative infrastructure financing modalities.** Infrastructure financing requirements are becoming increasingly dependent on the private sector, and ADB is proposing several financing instruments to leverage private sector funds. Key initiatives include building on the jointly developed credit enhancement product in association with India Infrastructure Finance Company to support local bond issuances by infrastructure project special purpose vehicles. Potential products include a bond guarantee fund for India, which will provide an institutional approach to mainstreaming a credit enhancement product, with a defined business plan and operational modalities. ADB is also evaluating two innovative financing projects—the India Infrastructure Debt Fund and Corporate Debt Market Support Facility.

16. **Sector regulatory frameworks and institutional reforms.** ADB has supported central and state governments and respective authorities to design and pursue policy mandates, and tariff and accounting reforms. It has also provided TA relating to tax, revenue, institutional, and governance reforms and capacity development. Targeted, effective knowledge products that draw on project preparatory and other TA work and address issues such as transmission access pricing and off-grid electrification options for India will be employed to influence policy and regulatory reform. Future products include improved solar mapping, a review of agricultural feeder separation activities, and the effectiveness of renewable energy promotion schemes.

17. **Public–private partnerships.** ADB has provided $16.5 million in TA through eight projects to assist the government’s PPP initiative, including support for PPP-friendly regulatory frameworks and capacity. PPP cells have been set up in various state governments and central line ministries; pilot projects have been developed in challenging sectors; and PPP policies have been drafted in various jurisdictions, including the PPP rules that recommend processes to be followed for PPP projects. ADB is currently supporting the preparation of a PPP manual and a PPP compendium for the operation component that will highlight global best practices. It is also supporting a green book on health (a nascent and unexplored field in India), with the aim of helping develop a model concession agreement on investments in the sector. ADB is also assisting the structuring of pilot PPP projects for urban water supply and sanitation, health, education, and mass transit systems. It will partner with the government and the private sector to help cities realize their full growth potential by identifying key infrastructure requirements and seek opportunities to increase community participation in PPPs. Given the advanced framework and experience in developing PPPs for some sectors, the focus will be on more challenging areas such as urban services, urban transport, food storage, and inland waterways. Some initiatives are ongoing and will be expanded to other CPS focus sectors.