JOURNAL OF ISSN 1529-0905

Bangladesh Studies

VOLUME 13 NO. 1 2011

TABLE OF CONTENTS

TABLE OF CONTENTS

Private Sector Participation in Infrastructural Development: A Non-Resident Infrastructure Fund in Bangladesh

M. Mahmudul Alam
and
M. Abu Rashed

Abstract

Infrastructure is considered as the engine of growth for an economy with possibilities of high return for investors. However, in Bangladesh the infrastructure sector has been constrained greatly due to fund shortage. Bangladesh is one of the highest remittance-recipient countries in the world, but the current savings schemes of the country are not attractive enough for the non-resident Bangladeshis (NRB). In this situation, an NRB Infrastructure Fund (NIF) can be established, where NRBs will invest in private infrastructure projects like toll roads, private power plants, land and seaport, etc. In 2004, the Government prepared the Bangladesh Private Sector Infrastructure Guidelines (BPSIG) that emphasized formation of NRB funds for infrastructure sectors. Except for three general mutual funds for NRB under Investment Corporation of Bangladesh (ICB), there has been no other initiative. The performance of the fund remains far below expectations. This paper proposes an NRB fund for private infrastructure development with option to trade the shares in the local market. The fund will be used for a longer period of time in the company in compliance with the infrastructure project parameters. The paper also provides some technical and commercial proposals for forming such a fund in the country and examines its impact on the economy as a whole.

Introduction

Bangladesh is one of the major labor exporting countries of the world. The total number of migrants from the country, officially, was 4.55 million from 1976 to 2006. This is approximately 3.5% of the total population who send remittances to Bangladesh. A Bangladeshi living outside the country for six months is termed as Non-Resident Bangladeshi (NRB). According to Siddiqui (2003), some 200,000 or more Bangladeshis leave the country officially every year to work elsewhere while more than 1 million Bangladeshis live outside the country permanently, reflecting the extent of emigration. Most of these migrants send part of their earnings back home on a regular or irregular basis.

The remittances sent by the NRBs amounted to $1.4 billion in 2005-2006 (Bangladesh Bank, 2006), which placed Bangladesh at 14th position among top remittance recipient countries of the world. The growth rate of remittance inflow into Bangladesh is also very high and was 23% in 2006 (The Daily Star, 2006). According to Berlage et al. (2003), who compiled data from a number of information sources, Bangladesh was the sixth remittance receiving country in 1999 in the world in absolute figures. In 2009, the remittance growth rate was 20% though migrant workers decreased by 46% from 2008 to 2009. In 2009, remittance inflow reached $10.7 billion (The Daily Star, 2010).

The Government of Bangladesh offers various savings instruments for the NRBs to attract remittances such as Non-Resident Foreign Currency Deposit (NFCD)[1], US Dollar Premium Bond[2], Wage Earners Development Bond[3], etc. Furthermore, Non-resident Bangladeshi investors enjoy facilities similar to those of foreign investors. For foreign direct investment, there is no limitation pertaining to foreign equity participation, i.e. 100 percent foreign equity is also allowed. Non-resident institutional or individual investors also can make portfolio investments in the stock exchanges in Bangladesh. Moreover, there is also a reserved quota for NRBs in case of newly issued shares/debentures (IPO) of Bangladeshi companies. Government of Bangladesh has also decided to select 50 Important Non-Resident Bangladeshis (INRB) to honor them by providing extra privileges, treating them as VIP, awarding certificates, providing public recognition, etc., for contributing to the national economy based on some criteria like investment up to USD $0.50 million in the industrial sector or remittances of USD $750,000 through proper banking channel.

In spite of such initiatives, sufficient investments from NRBs have not yet been received. A previous study (INAFI, 2004) showed that 80% of the remittances received is used in non-productive expenditures. It also indicates that the current saving scheme, industrial environment, investment opportunity, scope of lucrative and long term return are not attractive enough for the NRBs. To provide better investment opportunities for NRBs, as well as to develop the infrastructure sector of Bangladesh through private investment, the government has adopted a wide-range of liberalization initiatives and prepared the Bangladesh Private Sector Infrastructure Guideline (BPSIG). The Guidelines mention the private investor, a single or a consortium of few investors, especially NRBs as follows: “The Government shall encourage an infrastructure development fund or funds in which non-resident Bangladeshis may invest in developing Private

Infrastructure Projects" (BPSIG, 2004). The government has recently provided great emphasis on boosting private sector infrastructure projects (which are commonly known as Public Private Partnership or PPP projects) in the country. Special attention has been given to transport, power, health, and education sectors. The present government has adopted, for the first time, a PPP budget for fiscal year 2009-2010 which is parallel to the traditional development and revenue budget. The budget has provisions for technical assistance to develop new PPP projects in the country with a view to open up new opportunity for private sector investment. This will enable wider scope for NRBs to find more suitable PPP projects in which to invest.

But until now the government has not been able to take enough initiative to develop a NRB infrastructure fund in Bangladesh, except for three general mutual funds operated by the Investment Corporation of Bangladesh. The total current value of the three funds stands at an approximate value of USD $40 million up to June 2010 (DSE, 2010). These NRB mutual funds are like normal mutual funds in the stock exchange that maintain a portfolio consisting of the shares and bonds of any type of company and only involved in investment rather than any operational activities. This paper suggests a model for the NRB fund for infrastructure development with critical examination of its necessity for the country. This proposed fund focuses exclusively on private infrastructure related projects via Public Private Partnership (PPP) projects. Moreover, this fund will consider maintenance of a project portfolio including the shares and bonds of other existing infrastructure projects.

The Economic Role of NRB Funds

According to a recent study on investment in infrastructure needed in Bangladesh to achieve the Millennium Development Goals (MDG), an amount of USD $85 billion would be required in just four sectors: power, water and sanitation, roads, and telecom. This amount would exceed USD $100 billion if other infrastructure sectors are considered. The total investment in the currently pipelined private infrastructure projects is approximately USD $3,639 million. An NRB Infrastructure Fund is expected to bridge the deficiency. The initial size of the NRB Infrastructure Fund could be in the range of USD $7-15 million.

At the same time, the experiences of PPP projects in Bangladesh are very good; at least 35 PPP projects have been operational in power, land port, optic fiber, PSTN (Public Switched Telephone Network), etc. The rate of return of these projects generally vary from 15-30% (as evidenced from expected IRR in the tenders submitted and subsequent reflection in the concession agreement signed and Annual report of the Special Purpose Vehicles or SPVs). More than 80% of the PPP projects that have gone to tendering have been implemented in Bangladesh. Except few of them (3 land ports particularly), almost all other projects have been earning more than the projected IRR (as evident from the royalty they have been providing to Executing Agencies, otherwise there would be court cases, as these are fixed in the concession agreement). And none of the PPP projects has been calculated at less than 15% IRR as per the tenders submitted. This suggests that NRB infrastructure fund is not riskier. A number of PPP projects, especially under Investment Promotion and Financing Facility (IPFF), have been financed by Industrial and Infrastructure Development Finance Company (IIDFC), Infrastructure Development Company, Ltd. (IDCOL), Industrial Development Leasing Company (IDLC), and few other financial institutions (mostly with bank syndication). Now, basically for large PPPs, the existing PPP financing facilities are not sufficient. IPFF and IDCOL have come forward for financing some of them. The result was outstanding achievement (for IPFF of the World Bank with USD 57m, the planned four year project has been completed disbursing all the amount within two years) which emphasizes the necessity of alternative financing vehicles like the proposed NRB fund. This has a good potential market for the proposed fund.

Regarding the financing of PPP projects, the loan repayment period ranges from 10 to 25 years where IPFF provides for 20 years while Public-Private Infrastructure Development Facility (PPIDF) of IDCOL also provides for more than 15 years. But the most available and popular deposit schemes of commercial banks are shorter term, mostly for 5 years. So, the existing financial institutions (apart from that of IPFF and IDCOL) of Bangladesh are rarely willing to provide long-term loan facility to any project. As a result, investors of infrastructure projects suffer immensely from lack of funds. To address this difficulty, an infrastructure fund could be formed, which will provide investors with long-term financing facility.

Every year a huge amount of remittance comes into Bangladesh through unofficial channels. According to the World Bank's survey of households, informal sources of remittances are higher than that of formal channels (formal 46% and informal 54%) (World Bank, 2006). Studies show that 40% of total remittances are sourced through the illegal *hundi business*, 46% through official source, some 4.61% is coursed through friends and relatives, and 8% by migrant workers when they come home (The Daily Star, 2004).

In 2004, the central bank adopted strict measures to prevent unofficial channels of foreign exchange transfers. The Bangladesh Bank continues its efforts to encourage NRBs to send their money through official channels. Although the flow of remittance through official channels is increasing, changed economic policies in some emigration countries encouraged migrants to send more remittances to their home country. Moreover, the remittance inflow has increased due to the newly introduced, easier, and cheaper processes for sending remittance (The Daily Star, 2002). Earlier the Nationalized Commercial Banks (NCBs) were the main official channels to transfer remittance. The NCBs have some overseas branches in the United States, Europe and Middle East. But the process of transferring remittance through NCBs is lengthy and takes a few days. Consequently, private commercial banks (PCBs) have come forward with remittance business providing quick and reliable services and attracting the Bangladeshi wage earners to send money home through banking channels. Moreover, the recent financial crisis and meltdown of many banks around the world influenced NRBs to consider their home country as a safer place for savings. That is another reason remittance inflows increased since 2009.

Normally investment in the stock market and industrial sector is very risky for non-resident individuals who have no previous experience in these sectors and stay far away. As a result, their real opportunity for investment is too little to influence them to save and invest more in their home country. Thus, at present, if proper initiative can be taken, annual NRB investment would be more than US $1 billion in Bangladesh.

Formation and Operation of the Fund

The proposed infrastructure fund is planned to be created by pooling money from NRBs. This fund may be formed as a trust and also as a public limited company. The stakeholders of the fund will be sponsors, trustees, companies, and private investors – i.e., NRBs.

The Model of the NRB Fund

The fund is to be initiated by some sponsors who will create a trust on paper by a trust deed with some well known personalities in the Board of Trustees. For example, initially the chairman of the Board of Investments (BOI) or any renowned local person or NRB can chair the board of trustees. The sponsors will apply to the local registration office to register it as a trust. After the registration, the trustees will open a special purpose bank account of the trust. The sponsors will provide some 'seed money' in the account. Bangladesh Bank (the central bank of Bangladesh) can act as the lead sponsor and a few reputed financial institutions can also contribute. Then it needs to be registered as a public limited company. The board of trustees will work as the board of governor of the company and will appoint the CEO or fund manager and top executives to run the company. The company may invest in its own projects (for the long term) as well as other PPP projects of various SPVs. The company then applies to the Securities and Exchange Commission (SEC) for enlisting in the capital markets. Then the company will officially invite subscriptions from NRBs through floating shares of the fund.

Modes of Participation in the Fund

The NRBs will subscribe to shares of the fund by the following modes.

a) *Subscription through local account***:** A NRB can apply directly, by enclosing a foreign currency demand draft drawn on a bank payable at Dhaka, or through a nominee (including a Bank or a Company) by paying from foreign currency deposit account maintained in Bangladesh. The value of securities may be paid in Taka, US Dollar or UK Pound Sterling at the rate of exchange mentioned on the application form. Refund against over subscription shall be made in the currency in which the applicant paid the value of shares. The same could be reversed for withdrawing the investment.

b) *Subscription through foreign currency account*: Bangladesh government can open some foreign accounts in countries from where it receives majority of the remittances, like KSA, UAE, UK, USA etc., for facilitating the NRBs to subscribe into the infrastructure fund. Money from these accounts would be channeled into the fund at the company's disposal.

c) *Exiting from the fund***:** NRBs can exit from the fund by off-loading their shares in the stock market. This infrastructure fund will be listed in Bangladeshi stock markets. It can also be listed in other stock exchanges of some major countries like KSA, UAE, UK, USA, etc., from where most of remittances come. This will give NRBs an easy option to sell their shares and withdraw the investments.

Mode of Investment by the Fund

The Company would make investments with the pooled money after assessing potentially viable infrastructure projects. Based on the project selection and modes of investment, it will help to add value to this fund. This fund could be invested in two ways: equity and debt. Equity involvement could come in two forms:

i. *Direct equity***:** The fund can take part in the direct equity form when a project company is awarded with the contract of building or operating the private infrastructure projects. It can also act as a sponsor (equity holder) or subordinate sponsor during the submission of the bid documents to get the contract.

ii. *Pre-IPO private placement*: A company offers private placement scheme to institutional sponsors before floating IPOs to increase the credibility of the incumbent IPO. This incurs less cost for the company as it does not need any floatation or underwriting cost and it increases the credibility of the incumbent Initial Public Offering (IPO). The company can subscribe to this option of equity participation after analyzing all the critical issues of a company's financial strength. This share can easily be off-loaded once the company is listed in the stock exchange.

Debt involvement also comes in two forms:

i. *Direct Debt*: It is a direct participation (non-transferable) by the Infrastructure Fund for financing an infrastructure project and the debt terms which will be negotiated between the company and the lead financier. Generally, the debt portion of a PPP project is covered through banking syndication where a lead financier acts on behalf of the consortium members. This type of financing will enjoy the facilities as a senior lender, but as this is a long-term investment, high discretionary measures should be taken from the fund management's point of view.

ii. *Funded Debt*: This involves long-term debt and the instruments to be used are bonds and debentures (transferable). This is typically repaid in regular amounts over the life of the bonds in equal installments. The issuer of these instruments can buy it back from the holders before the stated maturity date at the call price, which is higher than the par value. This could be a good fund diversification tool as it is less risky but provides a guaranteed return. This type of financing will enjoy all the facilities a subordinate lender enjoys in the debt structure.

Discussion

The proposed company will help in channeling the remittances of NRBs for infrastructure development of the country. It has good potential to allow the huge amount of remittances to be tagged in a pool of funds which can be utilized for infrastructure development of the country. Generally NRBs invest through family channels or social relationships in discrete investments. If they invest in the fund, it has to ensure comfort to them that their investment is professionally managed. The operation of the fund will need to be supervised by national institutions such as Board of Investment.

The share price of the infrastructure fund would depend on the underlying portfolio of assets. So, it needs to be more careful about the investment. Finding good project is also a big challenge. Infrastructure funds have to access investments that would normally be unavailable to retail investors. The underlying assets should also have limited competition which will provide a sustainable competitive advantage. Essential infrastructures such as airports, roads and docks are crucial to a modern society and have very high replacement costs. So, minimizing the volatility of funds invested in these assets needs to be ensured for stable earnings.

At present, there are only two infrastructure company (IIDFC and IDLC) listed in Dhaka Stock Exchange (DSE). Hence, more infrastructure projects need to be generated and listed in the stock exchange for proper utilization of the fund. This fund may face the problem of keeping idle money at its disposal due to the scarcity of public infrastructure projects, and a provision should be there to invest this idle money in other private infrastructure projects and profitable sectors as well.

Conclusion

The reason for success with private infrastructure business or PPP is that it is a more secure business with generally guaranteed stream of revenue. Example can be given of Independent Power Producers (IPPs) with defined power purchase agreement. On the other hand, the fundamentals for the utility of PPP project is that a PPP generally generates lower level of competition as a government monopoly. The special purpose vehicle awarded a PPP project thus enjoys the benefit of doing an infrastructure business that generally has got huge market potential and certain stream of revenue over a long period of time. A PPP business by its very nature is attractive for private sector investors as realized through the number of bids submitted by interested bidders in the tender process for a PPP project.

For this purpose, NRB Infrastructure Fund is highly desirable for financing infrastructure projects in Bangladesh. The fund will pool money from NRBs by floating shares to NRBs with a size in the range more than US $1 billion per year. It can be formed as a trust leading to a public limited company where the board of trustees may be selected from renowned personalities of Bangladesh or NRB. Bangladesh Bank can be the lead sponsor of the fund with some seed money followed by other institutional sponsors, which will encourage NRBs to participate in the fund. This fund will be managed by a professional fund manager or executive body of the company, who makes investment decisions. The activities of the company will be monitored by the board of trustees.

The Fund will be invested in various infrastructure projects that will basically work to reduce the deficiency of overall infrastructure gap in the country and also ensure proper return for the NRBs. So, the structure of the fund or the company is a very crucial issue for its success. As NRBs are the key stakeholders, before forming the fund officially, the government should take the opinions of NRBs regarding several legal and administrative frameworks.

Endnotes

1. Non-Resident Foreign Currency Deposit (NFCD): This deposit account can be opened any bank operating in Bangladesh. The account can be opened for one month, three months, six months or one-year term in foreign currency i.e. US Dollar, Pound Starling, and Euro etc. The minimum deposit requirement is US $1000 or 500 pound starling or equivalent to other currency.
2. US Dollar Premium Bond: The Bond is issued for three years in the name of a holder of a non-resident account against remittances from abroad to the account. The Bondholder will be entitled to draw interest on half yearly basis at 7.5% fixed rate per annum in Bangladesh currency at the USD/BDT rate. However the Bondholder may surrender the Bond before maturity and encash the same at the paying office in which case lower interest will be paid.
3. Wage Earners Development Bond: Bangladeshi wage earners serving abroad and sending remittance in the country are entitled to purchase this bond. The Bond will mature for payment on or after five years from the date of its purchase and the annual interest rate is 12%. But the Bondholder may surrender the Bond and encash the same at the paying office after six months of purchase when he will be paid the principal amount together with interest on premature encashment rate.

References

Bangladesh Bank. (2006). *Bangladesh Bank Bulletin, Money and Banking*, pp 22, July-September.

Berlage, L., Havet, K., Leman, J. and Soenen, H. (2003). *Transfers van migranten: omvang en effecten*. VLIR, Brussel/KULeuven, Leuven.

BPSIG. (2004). *Bangladesh Private Sector Infrastructure Guideline*, Government of Bangladesh, Sce-3.11, pp. 6620, October.

DSE. (2010). Dhaka Stock Exchange, 10 June. Available at www.dsebd.com.

INAFI. (2004). *Harnessing Remittances for Economic Development in Bangladesh*. International Network of Alternative Financial Institutions, Philippines.

Kuddus, U. M. (2003). Channeling diaspora remittance into the securities market of Bangladesh. Internship report for IOM. Institute of Business Administration, University of Dhaka, Dhaka.

Siddiqui, T. (2003). *Migration as a livelihood strategy of the poor: the Bangladesh case*. Dhaka: Refugee and Migratory Movements Research Unit, Dhaka University. Available at http://www.livelihoods.org/hot_topics/docs/Dhaka_CP_5.pdf.

The Daily Star. (2002). Remittance marks 20.5pc growth during July-Nov. 4 January. Available at http://www.smc.org.ph/amnews/amn020715/southasia/bangladesh020715.htm.

The Daily Star. (2004). Remittance witnesses growth on contribution from expats in KSA-Flow declines from Malaysia, Kuwait, Bahrain. 25 July. Available at http://www.thedailystar.net/2004/07/25/d40725050147.htm.

The Daily Star. 2010. 2009 remittance sets new benchmark. 5 January. Available at <2009remittance sets new benchmark>.

World Bank. 2005. *Global economic prospects 2006: economic implications of remittances and migration*, page 92, World Bank, November 2005.

Md. Mahmudul Alam
Institute for Environment and Development (LESTARI)
National University of Malaysia (UKM)
Selangor, Malaysia
and
Research Fellow
Integrated Education and Research Foundation
Dhaka, Bangladesh
E-Mail: rony000@gmail.com

Md. Abu Rashed
Senior Consultant, Project Development
Infrastructure Investment Facilitation Center (IIFC)
An enterprise of Economic Relations Division (ERD)
Ministry of Finance
Government of Bangladesh
Dhaka, Bangladesh
E-Mail: arashed@infra-bd.com