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Industry Trends: Infrastructure

URBANIZATION: A MAJOR DRIVER OF INFRASTRUCTURE SPENDING

With urbanization a key driving factor, infrastructure spending is set to increase substantially over the coming decades. Who will carry out all this work, and how will it be funded?

Three megatrends – globalization, urbanization and digitization – are shaping global economic growth. That growth is, in turn, creating huge demand for private and public sector infrastructure development such as power stations, electricity grids, water supply and treatment plants, roads, railways, airports, bridges, telecommunications networks, schools, hospitals, and more.

The world may be suffering from an economic slowdown, with some countries, especially in Europe, feeling the pinch more than most, but the long-term outlook is positive. China, India and other large emerging markets are still registering strong growth and the advanced economies should start to recover next year and beyond.

Infrastructure is increasingly viewed by the World Bank as the vehicle for transforming low and middle income countries into emerging or developing nations. In fiscal year 2011, the bank committed $26 billion in infrastructure financing, accounting for 43% of all its commitments. "The developmental challenges that these

countries face are numerous, ranging from rapid urbanization to the threat of a changing climate, and catastrophic natural disasters," says the bank in an official statement. "To address these challenges, the infrastructure sectors – water, transport, energy and information and communications technology – have emerged as real agents of change."

Rapid urbanization in developing countries, and continued urbanization in advanced economies, will be the biggest driver of infrastructure spending over the next few decades. Today, 3.5 billion, 50% of the world's population, live in cities. By 2030 that will have risen to 5 billion, 60% of the population. This rise will require sustained infrastructure investment in railroads, highways, bridges, ports, airports, water, power, energy and telecommunications, creating massive opportunities for multinational contractors and their international and local suppliers.

Opportunities abound for infrastructure companies

ABB, the Swedish-Swiss multinational corporation and a leader in power and automation technologies, has firmly aligned its strategy to urbanization and the lucrative contracts it will create. "Experts estimate that over $40 trillion dollars will be invested in urban infrastructure over the next 20 years," says ABB in a corporate statement released at this year's World Economic Forum in Davos. This investment will include transportation, housing, hospitals and other social amenities, all of which will be reliant on electric power, ABB's core market.

Siemens, the German multinational electronics and electrical engineering company, employing 360,000 people in nearly 190 countries, is also tying its future to urban development. Its operating businesses used to be organized around three sectors, Energy, Healthcare and Industry, but in October last year it added a fourth, Infrastructure and Cities.

By forming this new sector, the company aims to be a leading participant in the dynamic growth of cities and infrastructure investments. "The Infrastructure and Cities sector will open up additional business opportunities in the growth market of cities," says Peter Löscher, Siemens' CEO.

No shortage of financing needs

The urban projects of the next few decades will be financed by public administrations and private contractors in the usual ways: equity capital, municipal and corporate bonds, project finance, public private partnerships (PPPs), private finance initiatives (PFIs), bank syndicated loans,

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and so on. However, these sources of finance are under pressure. Equity and debt capital is not as easy to raise as it once was, due to the dislocation of the capital markets, falling credit ratings and Basel III regulations. And in the United Kingdom, many PPPs and PFIs have been criticized for being poor value for money in the long run, a view that could spread.

Banks like Citi are able to offer alternative, often innovative, financing solutions for their infrastructure clients in the private and public sectors. Citi is promoting the urban agenda with its "Citi for Cities" initiative, which harnesses solutions and capabilities across the bank to provide a wide range of financial services. Citi operates in approximately 140 countries, and besides financing large urban projects, is part of the financial infrastructure ecosystem of many cities.

Global Transaction Services (GTS) is the division of Citi that provides treasury management, trade finance, and securities and funds services to companies, public sector bodies and financial institutions in about 100 countries. GTS handles 5 million transactions a day, in 135 currencies worth $3 trillion.

For city administrations, we assist in collecting taxes, fees and fines; paying staff; procuring goods and services; managing cash flow; providing ticketing systems for transport systems; and much more. For companies operating in these cities, we provide a similarly wide range of solutions, including liquidity and cash management, export agency finance (EAF), accounts receivables solutions, and supplier finance (see box).

Looking ahead

Predicting the future is always fraught with difficulty, but a report published by the Urban Land Institute and Ernst & Young, entitled *Infrastructure 2011: A Strategic Priority*, not only sums up the current issues facing infrastructure companies and public administrations, but looks a few years ahead. It explores how many nations and cities are finding it hard to develop necessary infrastructure policies. Most leading countries see infrastructure repair and development as high priorities for the future, "but struggle to address funding shortfalls," write the authors.

The United States still shows no signs of developing a national infrastructure plan and spending lags behind other major countries, but the outlook is good in other parts of the world, according to the report. The United Kingdom has committed £200 billion between 2011 and 2016 on rail, energy and broadband infrastructure projects; Canada is expanding its PPP initiatives to update aging facilities; China is building new power stations, airports, ports and subways; the UAE and Kuwait are using oil wealth to build transport hubs and seek energy-efficient solutions for future power and water needs; and Brazil is preparing for the 2014 World Cup and 2016 Olympic Games.

As a major financial provider, Citi is playing an important role in these and countless other projects around the world. Working in partnership with public administrations, companies and suppliers, we look forward to building firm foundations for sustainable economic growth well into the future.

Three financing solutions for the infrastructure sector

Export agency finance

Companies exporting to overseas clients often seek help from their country's official export credit agency (ECA) or a multi-lateral financial institution (MFI).

ECA services include helping:

- Overseas buyers purchase goods or services by guaranteeing bank loans to finance those purchases
- Exporters sell goods or services by guaranteeing payments due under bills of exchange or promissory notes.

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Accounts receivable

Payments due from customers can add up to significant amounts of trapped cash. Citi's global receivables solutions help companies streamline receivables processing, reduce days sales outstanding (DSO), release trapped cash as early as possible, and optimize working capital.

Supplier finance

Supplier finance is widely used by large corporations to provide suppliers with early payment. It is like factoring, except that supplier finance is initiated by the buyer, with Citi basing the arrangement on the high credit rating of the buyer. Factoring, on the other hand, is initiated by the supplier, with the arrangement based on the lower credit rating of the supplier.

Because supplier finance is based on a higher credit rating, the supplier finds it easier and cheaper to arrange than factoring. The benefit for buyers is the ability to help suppliers access affordable finance, and the likelihood of being able to negotiate more favorable payment terms with a positive impact on DSO. It also helps protect supply chains from both economic and competitive pressures.