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Innovative Financing Solutions: Accelerating India's Infrastructure Development

March 2022

Content

Joint Foreword by Deloitte and ICEMA

Recognised as a key driver of economic growth and employment, the global construction industry is poised to grow from US$7.26 trillion in 2021 to US$14.41 trillion in 2030 (a CAGR of 7.3 percent). Almost 57 percent of this growth is likely to be contributed by three leading countries – the US, China, and India.

Some key initiatives of the Government of India which will place India amongst the top global 3 contributors are Gati Shakti Mission, National Infrastructure Pipeline, National Monetisation Plan, and Bharat Mala Project. These will also drive economic growth of the country through the cascading impact. Industry welcomes the accompanying structural reforms initiated by the government and the establishment of the NaBFID which will accelerate infrastructure development in the country.

This impending growth in the construction industry is expected to have a consequent positive impact on the growth of the Construction Equipment (CE) industry in India. India's construction equipment industry is expected to be on a growth trajectory on the back of the Government of India's plans to invest US$1.4 trillion between FY20 and FY25 and an environment enabled by the structural reforms.

However, the Indian CE industry's growth is being stymied by challenges such as rising input prices, availability of skilled/trained manpower, and access to finance. Both the borrowers as well as the financiers face several challenges in financing the sector. Restricted access to finance arising out of limited options and inadequate penetration of alternative financing solutions being one of them.

To enable the CE industry to play a critical role in infrastructure development, the finance ecosystem of the country needs to be strengthened. For instance, the government could consider according the CE industry with "priority sector" status for lending, which will help enhance access to finance for construction companies and contractors.

The CE financing industry has been making efforts to enhance access to finance with several disruptive innovations, which are outlined in this paper. The adoption of alternative financing methods led by increasing financial and digital literacy has provided an enabling environment for innovative models to emerge. Against this backdrop, ICEMA together with various stakeholders across the value chain is working towards building a robust financial ecosystem for the CE industry in India.

The Indian CE industry is enthused by the encouraging words of Mr K V Kamath, Chairman, National Bank for Financing Infrastructure and Development (NaBFID) "Infrastructure is the bedrock of a nation. And the construction equipment industry makes infrastructure happen".

Infrastructure: An enabler for India's US$ 5 trillion economy

The context for infrastructure development in India

India has traditionally been an infrastructure-deficient country. However, over the past few years, infrastructure development and construction have been at the forefront of public and economic policy. This is being recognised as a key driver for achieving the government's goal of a US$5 trillion economy by FY 2024-25. This is clearly evidenced by the increase in infrastructure spend, which is expected to rise from about US$1.1 trillion (during FY 2008-17[1]) to ~US$1.4 trillion by FY 2024-25.[2] Further, rapid urbanisation and an increase in nuclear families have created massive demand for housing. There is need to update and modernise public and private infrastructure to cater to the requirements of the 21st century. This would significantly increase construction activity in India, which is expected to be the third-largest construction market in the world by the end of 2022.[3]

Recognising the economic benefits of infrastructure and housing development and also its employment generation potential (the construction sector is the second-largest employment generator in India, after agriculture), the Government of India is making a policy push with various programmes, such as National Infrastructure Pipeline (NIP), Gati Shakti, National Monetisation Plan, and housing schemes to create an enabling environment for such development.[4]

Accelerating GDP growth

The Government of India launched the NIP programme in 2020 to act as an enabler to provide and infuse funds that India would need for infrastructure development. NIP covers the period from FY 2020 to FY 2025 and comprises economic and social infrastructure projects with a total outlay of ~US$1.4 trillion.[5]

In the Union Budget for FY 2022-23, a year-on-year increase of more than 35 percent in capital expenditure was announced with proposed infrastructure spend of more than US$130 billion.[6]

Figure 1: NIP and sector coverage[7]

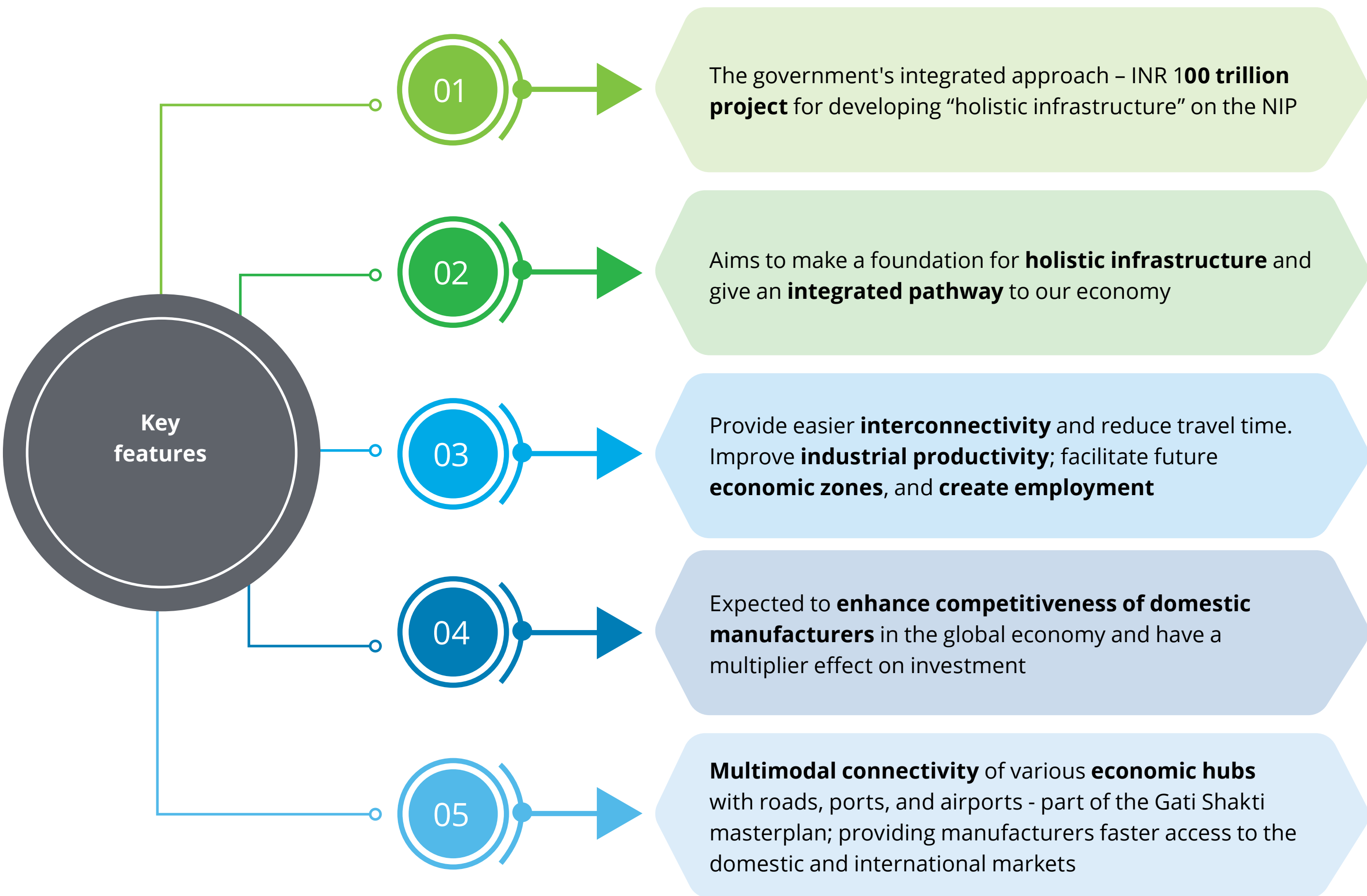
Ministry/Department	FY 20-25 (USD bn)	% of total
Energy	346	23.9%
Roads	277	19.2%
Urban infrastructure	229	15.9%
Railways	193	13.4%
Irrigation	109	7.5%
Rural infrastructure	109	7.5%
Airports	20	1.4%
Social infrastructure	50	3.5%
Telecommunication	45	3.1%
Industrial infrastructure	43	3.0%
Ports	14	1.0%
Agri and food processing infrastructure	9	0.6%
Total	**1,444**	**100%**

Enabling India's manufacturing competitiveness through logistics efficiencies

India has a logistics cost to GDP of ~14 percent and was ranked 44th in the 2018 Logistics Performance Index published by the World Bank.[8] With significant investments in the manufacturing sector, supported by the Production Linked Incentive (PLI) schemes that have a total outlay of US$25.6 billion across 13 sectors, competitiveness of India's supply chain becomes a key priority.[9] The Government of India aims to reduce logistics costs by five percentage points over the next five years (2022-2027) – from the current 13–14 percent of GDP to about 8 percent of GDP.[10] This will enable India to be in the top 25 countries in the World Bank's Logistics Performance Index.[11] Therefore, logistics efficiencies driven by infrastructure is a key driver of the US$5 trillion GDP vision.

One of the key levers to optimise logistics costs is integrated and seamless multimodal transport infrastructure, including the last mile connectivity. The PM Gati Shakti initiative, which was launched in November 2021, is a national master plan for multi-modal connectivity. It is a digital platform to bring 16 ministries, including railways and roadways, together for the integrated planning and coordinated implementation of infrastructure connectivity projects. A Unified Logistics Interface Platform (ULIP) is planned for data exchange amongst various operators through the application programming interface to achieve regulatory and operational streamlining.

Figure 2: Key features of Gati Shakti[12]

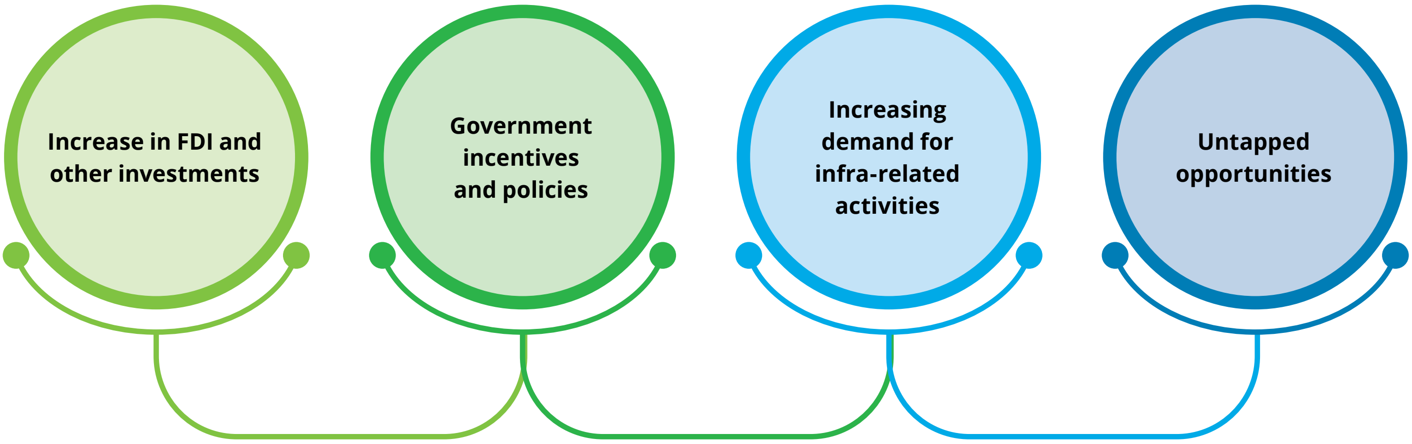


Construction Equipment (CE) industry: Driven by infrastructure growth

Growth drivers for the Construction Equipment (CE) industry

The CE industry's growth is directly related to proposed infrastructure development and investments in new projects. The following figure shows key growth drivers for the industry in India:

Figure 3: Growth drivers for CE



Foreign Direct Investment (FDI) and other investments

Increase in investments, such as FDI, helps boost the sector's growth:

- In FY 2021, infrastructure activities accounted for 13 percent of the total FDI inflows of US$81.72 billion.[13]
- Increase in private equity/venture capital investments in India has resulted in large investments in infrastructure. Indian venture capital firms have raised an investment of US$17.2 billion during January-July 2021.[14]

Government policies

The Indian government has been developing and implementing policies to support the creation of world-class infrastructure within the country. This includes building power plants, bridges, dams, roads, and other urban development projects. Some of the recent initiatives include the following:

- The National Bank for Financing Infrastructure and Development (NBFID) was set up in March 2021 as a development finance institution to fund infrastructure projects in India.
- For the holistic development and upgrade of infrastructure, multiple schemes/programmes, such as Bharat Mala, the Regional Connectivity scheme, Pradhan Mantri Awas Yojana, Atal Mission for Rejuvenation and Urban Transformation (AMRUT), Swachh Bharat, Mass Rapid Transit System (MRTS)/Metro, Jal Jeevan Mission, have been implemented through various ministries over the past few years. These constitute a part of the NIP. The National Monetisation Pipeline (NMP), which is expected to bring in an estimated revenue of INR 6 lakh crore by FY25, will be used for financing NIP.[15]
- Providing long-term interest-free loans (50 years) to states as part of the scheme for financial assistance for capital investment. The scheme aims to facilitate states' participation in infrastructure development.

Increasing demand for infrastructure-related activities

An increase in infrastructure-related activities, especially in urban areas, will lead to high demand for CE:

- The construction industry in India is expected to reach US$1.4 trillion by 2025.[16]
- The real estate industry in India is expected to reach US$1 trillion by 2030 and will contribute 13 percent to India's GDP.[17]
- India is expected to become the third-largest construction market globally in 2022.[18]

Untapped opportunities

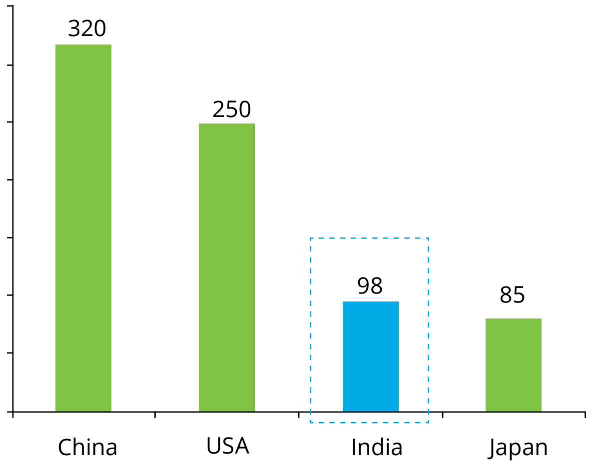
- High valuations of infrastructure projects make the sector attractive for investment.
- National highways in India present a great opportunity as only 24 percent of the network is four-lane.[19]
- The Regional Connectivity Scheme (RCS) plans to connect underserved airports with major airports via regular flight services, requiring infrastructure improvements.

Demand for Construction Equipment Financing (CEF) is linked to performance and growth prospects of the construction industry; this is largely driven by investments in end-use sectors, such as mining, urban infrastructure, roads, ports, irrigation, power, real estate, steel, cement, and automobiles. The construction sector has made concerted efforts to automate its processes, resulting in higher demand for CE.

Current state of the CE industry in India

The Indian CE industry is the third largest in the world with the total sales of 98,000 units.[20] However, it is significantly smaller compared with China and the US.[21]

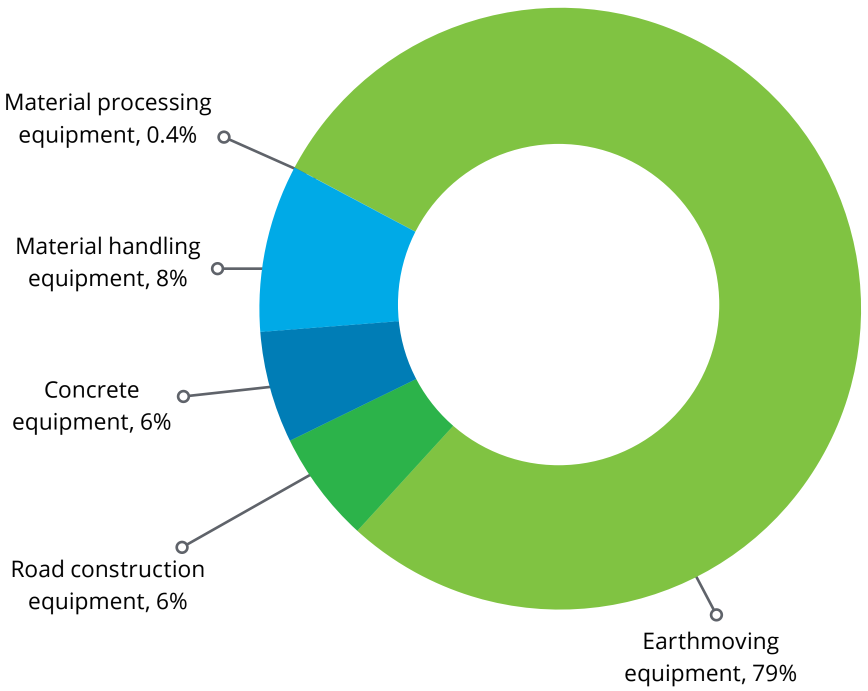
Figure 4: CE industry sales, 2019 (000's units)[22]



Dynamics in the CE market

The market can be broadly divided into five main categories: earthmoving equipment, road construction equipment, concrete equipment, material handling equipment, and material processing equipment.

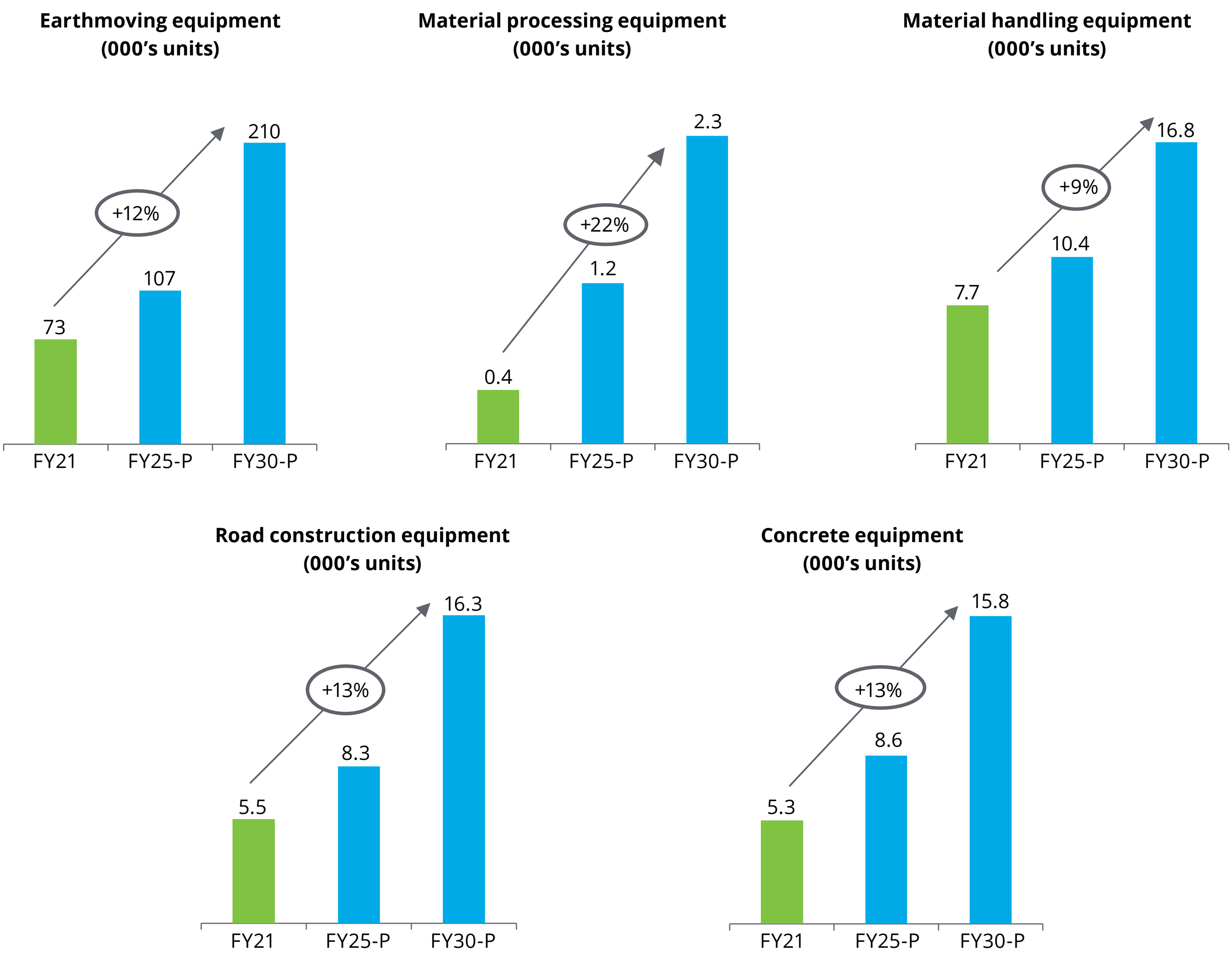
Figure 5: Share breakdown by state (based on sales volume for FY 21)[23]



Outlook for the domestic CE market: Impact of infrastructure investments

With the NIP and Gati Shakti in perspective, growth in the construction, earthmoving, material handling, and mining segments is expected; earthmoving equipment is the largest across key segments. The market is expected to grow at a CAGR of 12 percent to reach sales of 260,000 units by 2030.[24]

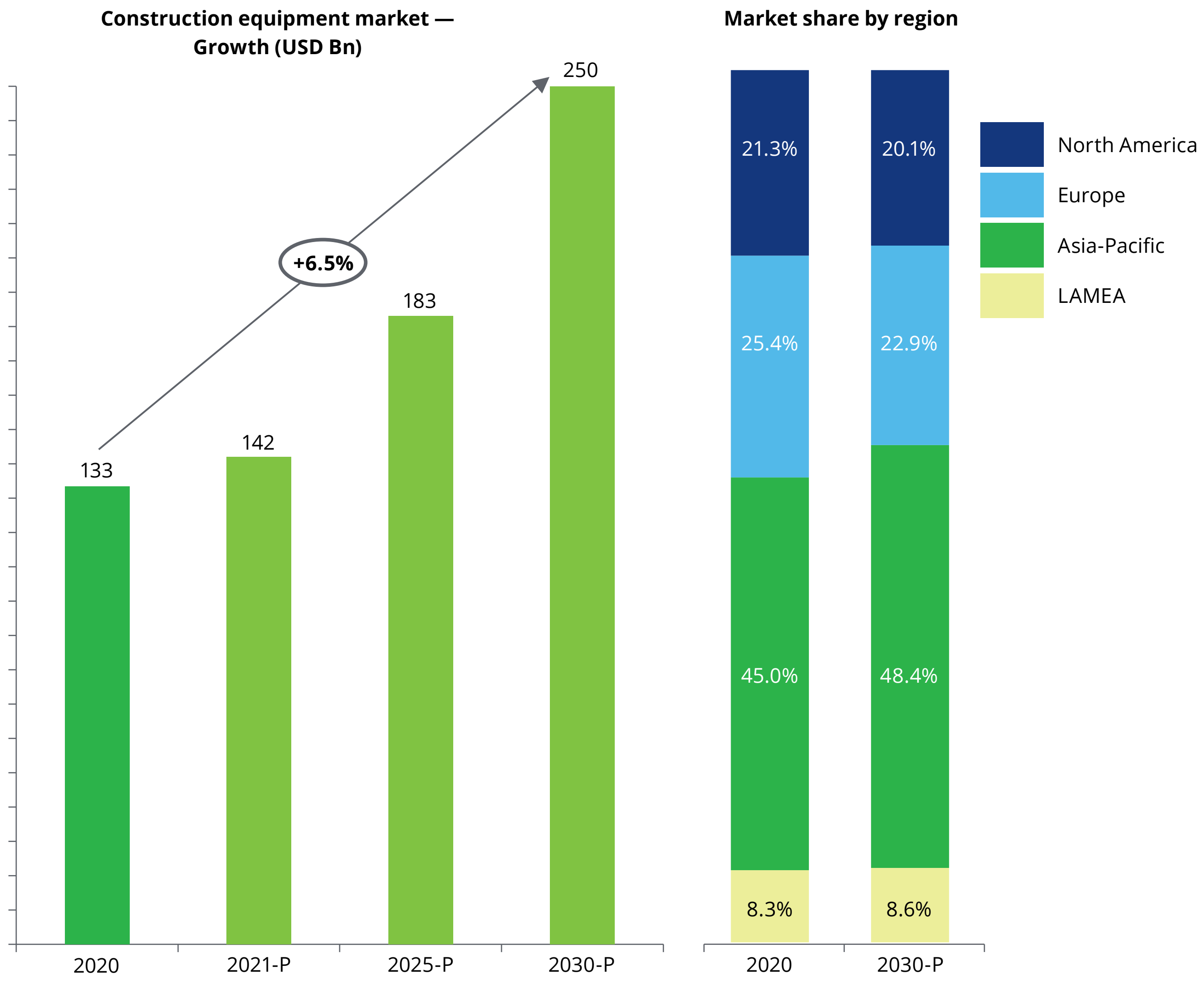
Figure 6: Growth outlook by segment for the CE market[25]



Opportunities in the global CE market

In addition to significant opportunities that the Indian market presents, there is a near-term opportunity for the CE industry to use global growth across regions and accelerate India's global value chain participation. With a CAGR of ~7.3 percent, Asia Pacific is expected to be the fastest-growing region.[26]

Figure 7: Global CE market size and growth[27]



Given the numbers in the above-mentioned graphs, India would have a CE industry with economies of scale and scope by 2030. The industry value chain is envisaged to increase employment by an additional 3.2 million by 2030 from the current level of ~3 million.[28] Financing and timely completion of infrastructure projects and the resultant use of construction equipment would be key for the industry's growth.

CE financing industry: Current state and disruptive innovations

Current state of financing in the CE industry

Large capital expenditure is required to fund the CE industry. Thus, financing is a good way for the industry to drive demand and increase the customer base. External financing makes up a significant share of the total equipment purchased. Financing used equipment necessitates enhanced due diligence, including more thorough valuation checks. As there is a higher risk associated with used equipment, financiers charge a higher rate of interest. The key instruments of external financing are buyers/ suppliers' credit, loan financing, leasing, and renting. Loan financing makes up a significant portion of external financing in comparison with leasing. Micro, Small, and Medium Enterprises (SMEs) find it difficult to raise financing from banks. Hence, they borrow at a higher rate of interest from non-bank financing corporations (NBFC). Large entities are predominantly funded by banks.

Key customer segments and buying behaviour in CE financing

The key customer segments for CE financing and their attached behavioural characteristics are mentioned below:

1. First-time buyers: They are new to buying CE. They are price conscious and find it difficult to access credit from traditional sources due to the absence of a credit history.
2. Retail buyers: They are small players who have purchased CE before. They are price conscious but also give due consideration to quality. They typically have a limited credit history.
3. Strategic captive: They are established players in the market and make purchases from a long-term investment standpoint.
4. Strategic contractors: They buy machinery/ equipment only after a contract is awarded.
5. Strategic hirers: They have a similar business profile to strategic contractors, but manage a fleet of machines/equipment on rent instead of buying and owning them.

Figure 8: Buying behaviour across CE customer segments

	First-time buyers	Retail customers	Strategic captives/ contractors	Strategic hirers
Experience of purchasing CE	Low	Medium	High	High
Equipment quality consciousness	Low	Medium	High	Low
Price sensitivity	Medium	Medium	High	High
Availability of credit history	Low	Medium	High	High
Access to finance from banks and NBFCs	Low	Low	High	High

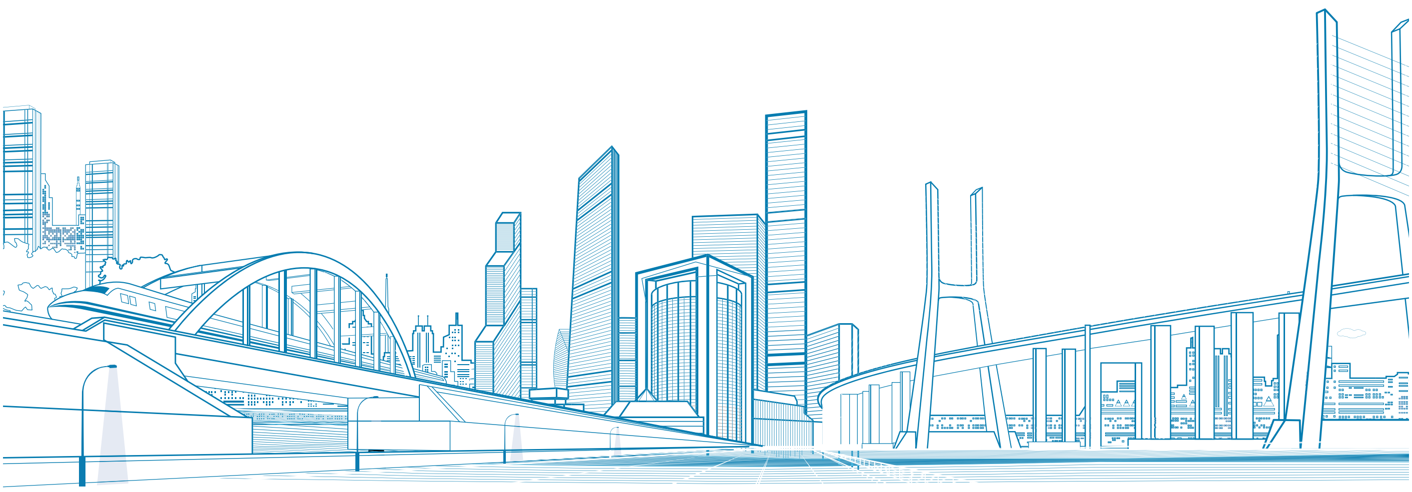
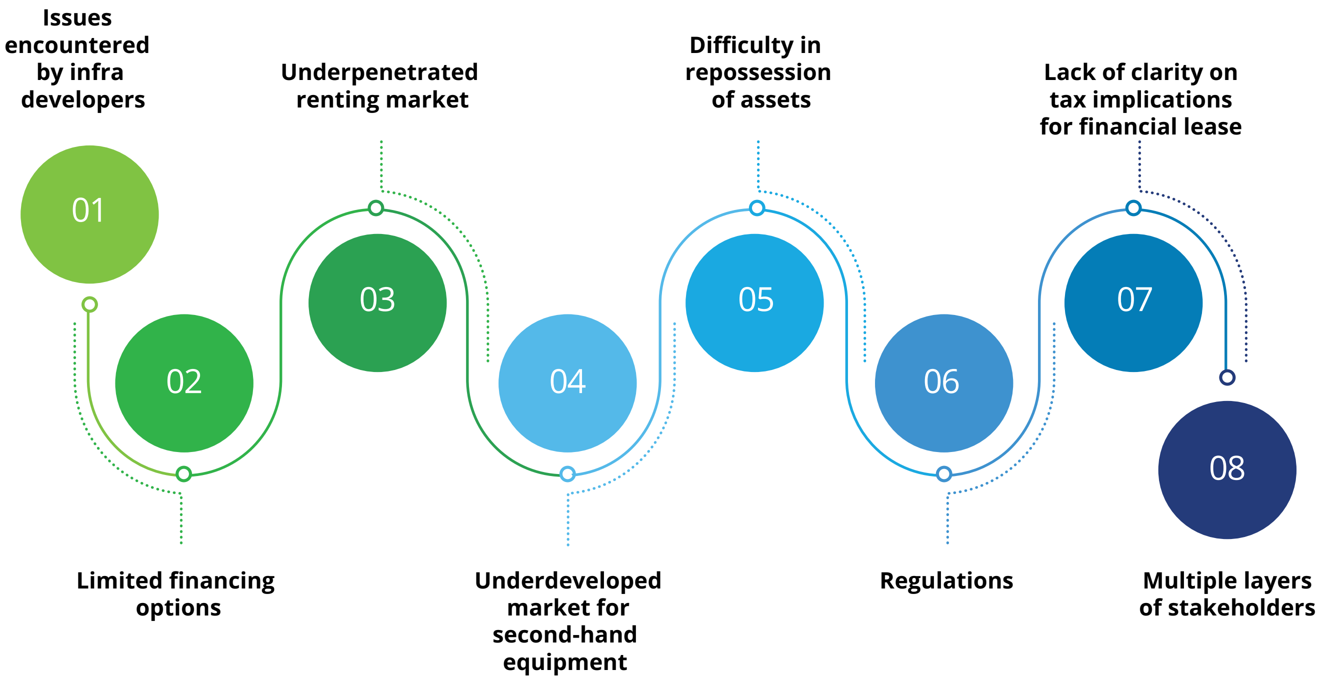


Figure 9: Major challenges faced in financing the CE sector



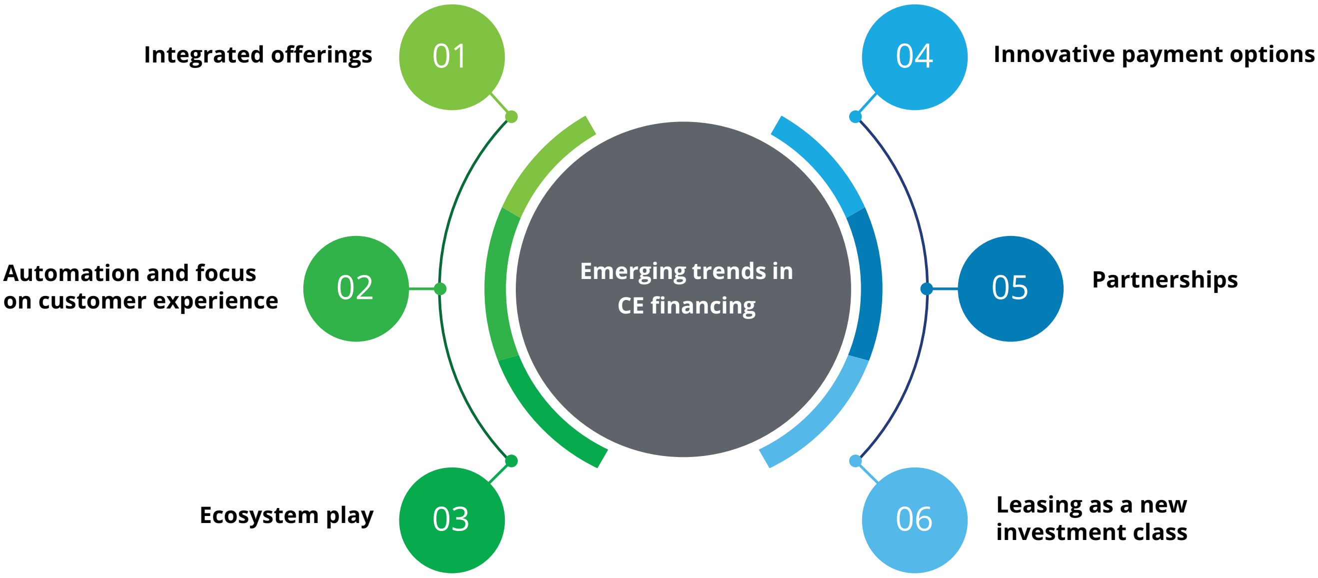
1. **Issues encountered by infrastructure developers in case of escalations, financing, and force majeure:** Escalation clauses are inadequate to cover for any increase in input costs (e.g., fuel and steel), long drawn claim processes, difficulty in accessing long-term financing due to a low-risk appetite of banks and NBFCs, and no recourse in case of force majeure.
2. **Limited financing options:** Construction companies and contractors get limited financing options, especially if they are first-time users, for whom the payment terms are often unfavourable.
3. **Under-penetrated renting market:** Renting is a good option for users wanting to limit their large capital expenditure. However, renting penetration in India is much lower than that in other large markets.
4. **Underdeveloped market for second-hand equipment:** Used equipment and secondary sales are unpopular in India because of lack of established trading platforms and buyback schemes from OEMs.
5. **Difficulty in repossession of assets:** Banks and NBFCs often face delays in the legal process for repossession of assets.
6. **Regulations:** The regulatory framework can be evaluated and amended to reflect the requirements of both borrowers and lenders.
7. **Lack of clarity on tax implications for financial leases:** There is no clear legal guidance on whether the lessor or lessee should be regarded as the 'owner' of an asset to claim depreciation.
8. **Multiple layers of stakeholders**: Navigating through many layers of contractors and sub-contractors affects efficiency in operations for equipment users and results in limited transparency.

Disruptive innovations in CE financing

Emerging trends in CE financing

The growth in the CE market will be fueled by increased infra-investments, expansion of urban infrastructure, economic corridors, etc. With the CE industry looking to take advantage of new and evolving opportunities, hassle-free flow of funds becomes crucial. Several new trends are emerging in this space that are disrupting the way products are offered and consumed.

Figure 10: Emerging trends in CE financing



1. **Integrated offerings:** Players offer an end-to-end solution, such as asset lifecycle management, to customers. This one-stop solution covers evaluation, leasing, procurement, insurance services, maintenance, and upgrades to equipment returns. They also offer equipment recommendations based on business needs/technical requirements and return on investment.
2. **Automation and focus on customer experience:** Traditional equipment financing can take up to a month before the machine is handed over to the customer. The use of FinTech has simplified complex and time-consuming processes, such as credit decision-making. Using the state-of-the-art technology, such as Artificial Intelligence (AI) and big data frameworks, FinTech solutions help lenders partially automate the credit decision-making process through enabling auto-approvals based on a borrower's credit history. Players also invest in online tools to provide greater transparency and improve customer experience.
3. **Ecosystem play:** Platform-based aggregator solutions (which allow customers, equipment manufacturers/traders/lenders, and financiers to interact seamlessly) and hybrid companies (which combine modern

technology with traditional channels) are leading this revolution in CE financing. These 'phygital' platforms are differentiating themselves from traditional players in many ways. They are using conversational commerce and franchisee models for fulfilment, building networks of right suppliers, and leveraging analytics to match demand and supply, AI, and NLP, to make product recommendations and digitise inventory for their clients.

4. **Innovative payment options:** Customer preference is shifting in favour of managed services (bundling equipment, services, supplies, and software), subscription models, pay-per-use rentals, standard or customised automated payment schedules (bullet payments, skip payments, etc.), reward programmes, and refinancing and alternative financing. This shift is encouraging equipment finance companies to find innovative ways to meet demand.
5. **Partnerships:** Several OEMs have set up captive financing and leasing units. This trend is expected to continue. Banks and NBFCs have fostered exclusive partnerships with construction equipment manufacturers to fund their dealers. Banks have also set up special lease financing verticals.
6. **Leasing as a new investment class:** Lease investing is also becoming popular in the Indian market as an excellent diversification tool in the asset-backed investment space. The reach of investment platforms offering these services is not only limited to high-net-worth individuals and family offices but also cover retail investors.

Global examples of FinTechs in CE financing

A US-based platform for construction lending and spending connects construction lenders with construction companies, general contractors, homebuilders, and other industry participants in real-time. It aims to improve the flow of capital through the ecosystem. The company's leading lending product gives lenders, borrowers, and contractors a centralised platform to efficiently manage construction loans, eliminate manual processes, and reduce risks and inefficiencies. Other lending products include asset management and home builder finance solutions. The platform also offers project documentation and payment management solutions for construction companies and contractors.

A US-based FinTech offers material financing for contractors and suppliers. By paying suppliers upfront for equipment and material, and offering contractors flexible 120-day terms for repayment, the platform aims to alleviate cash flow problems for small-scale construction companies and contractors.

A multinational financial automation platform offers several products and solutions to meet CE financing and project management, with an aim of automating workflows and minimising errors. The company offers a banking platform for contractors, with construction-specific rewards on debit card purchases. It also offers a financial data forecasting platform and workflow automation system to improve business outcomes.

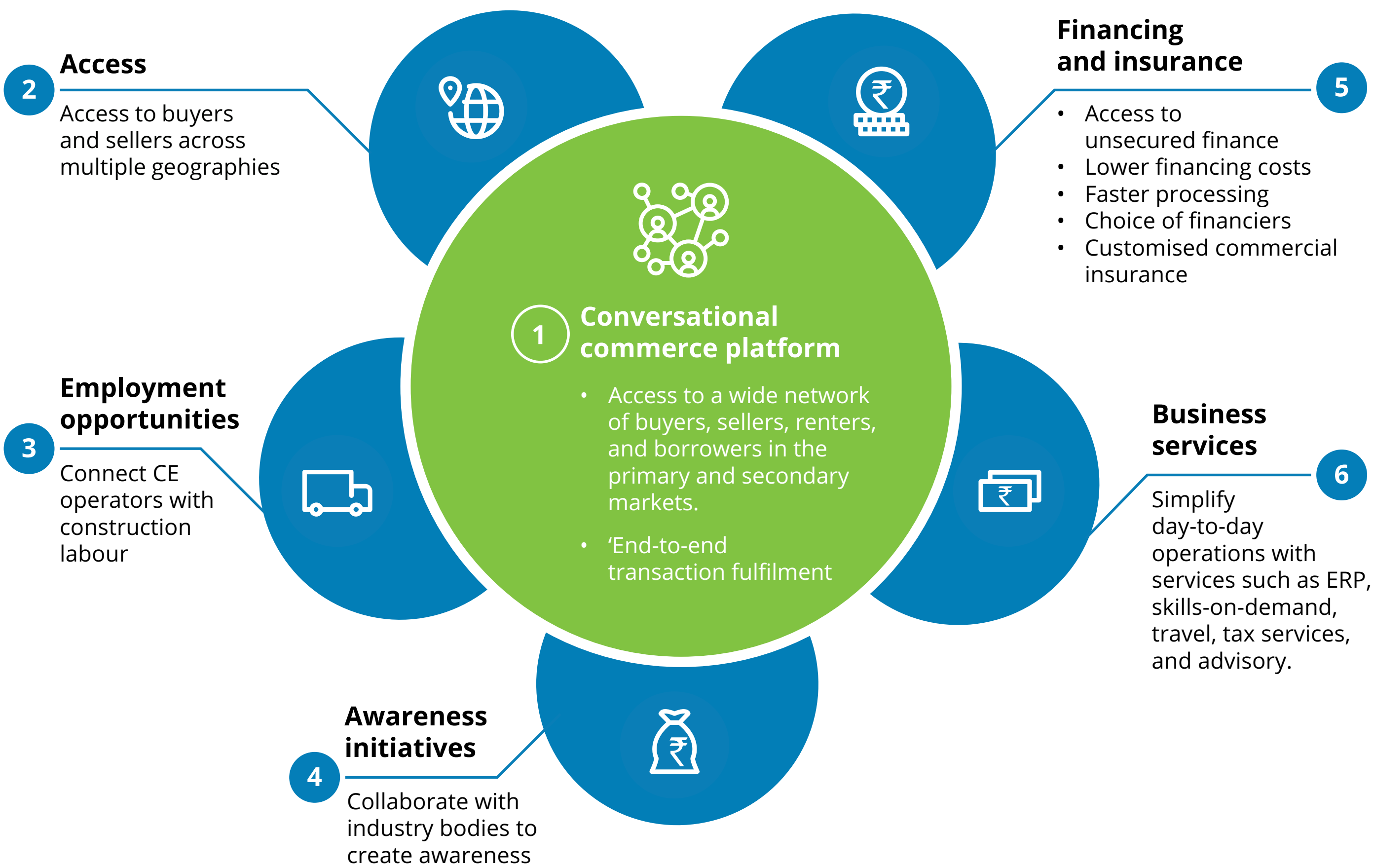
Road ahead for CE financing in India

High growth projections for the construction sector will have a trickledown effect on formal equipment financing, leasing, and rentals. Small construction companies and contractors from tier 2 and 3 cities are expected to drive demand for leasing and renting in the next few years.

Intervention across the value chain by various stakeholders is necessary to create a more conducive environment for equipment financing. The following recommendations would deepen and broaden the CE financing market in India:

1. **Emergence of platforms:** Platforms will help various stakeholders come together to meet the ecosystem needs of customers – obtaining financing, insurance, and other allied services; and generating revenue opportunities using data monetisation and near real-time demand matching.
2. **Co-lending**: Financial institutions can look at co-lending initiatives to take joint propositions to customers with better agility and lower costs.
3. **Buyback schemes and used equipment exchanges**: Such platforms can help aid the penetration of leasing and renting in India by improving the activity in the secondary market, enabling reach to a wider segment of customers, and offering better end-user pricing.

Figure 11: Platform of the future[29]



Key enablers

- Technology and data intelligence capabilities (UI/UX, business rules engine, risk scores, integration)
- Partnership ecosystem (Financial institutions, logistics providers, insurers)
- Channels (Feet-on-street, anchors and aggregators, referrals)
- Rewards programme (Reward points for transactions and the referral scheme)

4. **Use of innovative payment mechanisms:** Emergence of innovative payment mechanisms, such as subscription and pay per use rentals, is expected to help reach untapped buyers. Financiers should focus on offering innovative payment structures, such as:
    a. Bullet payments: Pay a lump sum loan amount at the time of maturity.
    b. Skip payments: Permit payment reductions and abatements for one or a few repayment cycles, to help customers during bad business cycle/seasonal cash flow issues and in case of unforeseen risks (such as adverse weather events, pandemics, and economic crises).
    c. Step-up and step-down payments: Provide flexibility by allowing customers to repay higher or lower principal amount during the beginning of the loan, based on their credit worthiness, nature of business, etc.
    d. Balloon payments: Pay a majority of the loan amount at the time of maturity.
    e. Rent to purchase: Give an option to purchase the rented equipment.
5. **Focus on digitisation and end-to-end services to improve customer experience:** Equipment financing companies would move to automation route in the current technology-led market. For example, transparency with a process to manage documentation, including EMI payments. CE financing companies should look to adopt a digital-first approach to cater to an increasingly connected and digitised Indian market, making the customer experience transparent, instant, and consistent. A special **focus should be on providing end of life services and retaining customers.** This can be ensured by providing support on disposal of obsolete equipment, offering the right price for it, and suggesting an alternative at a competitive price.
6. **Technology to bring operational efficiencies for end customers:** Using connected technology and Internet of Things (IoT) can help bring in operational efficiencies. Companies use the connected technology for real-time monitoring (of usage, location, etc.) and remote management of equipment, helping operators boost productivity, reduce operational costs, and increase profits.
7. **Changes in taxation rules:** The draft Income Computation and Disclosure Standard (ICDS) on leases released by the Central Board of Direct Taxes (CBDT) in 2015, provided that the lessee (and not the lessor) shall be entitled to depreciation in case of an asset acquired under the finance lease.[30] However, the ICDS on leases is yet to be notified.
8. **Regulatory reform:** Financing in India is primarily driven by priority sector lending requirements of banks. Given the contribution of the construction sector to infrastructure development and employment generation, CE financing can be included under PSL.

9. **Streamline the process for repossession of assets:** Create adequate mechanisms/processes to ensure the timely enforcement of security.
10. **Promotion of leasing and renting by industry bodies:** Industry bodies can look at promoting renting and leasing as an alternative source of financing, especially for MSMEs facing capital constraints and challenges in accessing traditional mediums of finance.
11. **Enable large rental companies to act like an FI:** Provide access to credit history, credit reporting to bureaus, and legal recourse in case of default to help rental companies better understand customers' intentions and their willingness and ability to pay.

CE financing in India is undergoing a paradigm shift as equipment lease/rental gains traction and new avenues, such as FinTech and LeaseTech, crop up. Despite India's status as a laggard in adopting alternative financing methods, high planned infrastructure expenditure in the public and private sectors, coupled with increasing financial and digital literacy, will fuel demand for these emerging financing options in the next few years.

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About ICEMA

ICEMA is an apex association for construction equipment manufacturers in India and represents over 80+ leading companies that manufacture, trade and finance a wide range of Construction, Earthmoving, Mining & Material handling equipment used in developing the robust world-class infrastructure for the nation. Constituted in 1949 as Tractor & Allied Equipment Manufacturers and Importers Association Ltd., the association started with 10 Indian member companies, primarily manufacturers and importers of tractors, earthmoving and allied equipment. It was rechristened as Indian Earthmoving & Construction Industry Association Ltd. (IECIAL) in 1986 with the objective to make the body a national point of reference for the Indian earthmoving & construction equipment industry. In 2012, the association was renamed as Indian Construction Equipment Manufacturers Association (ICEMA), with the objective to make the association a truly representative body of the Indian construction equipment industry and to expand its scope of services. The association boasts of a stellar legacy of 70+ years.

ICEMA represents OEMs covering 95% of the total CE Industry in India, apart from other leading companies who manufacture, trade and finance a variety of products including hydraulic excavators, wheel loaders, backhoe loaders, motor graders, vibratory compactors, cranes, dumpers, tippers, forklifts trucks, dozers, pavers, batching plants, diesel engines, etc. A non-government & not-for-profit organization, ICEMA serves as a reference point for India's CE industry. From influencing policy to encouraging debates and engaging with policy makers, ICEMA articulates the views and concerns of CE industry in India. It serves its members from the Indian private & public corporate sectors and multinationals and derives its strength and sustenance from the membership which is key to its subsistence. The membership of the association includes OEMs, component manufacturers, financiers, banks and insurance companies that play a key role in charting out the key policies for overall economic growth & development of CE industry in India.

In pursuit of its nation building endeavour, ICEMA supports and guides the CE industry and engages with governments and policy makers in shaping new policies, works towards development of new standards for construction equipment and creates platforms for knowledge dissemination. The Association is a bridge between the Indian and global construction equipment industry by interfacing with international counterparts.

A key aspect of ICEMA's work includes promotion of safety, setting of emission norms, technology integration & adoption, as well as continuous stakeholder engagement. To help improve the industry's efficiency, ICEMA also engages in developing a skilled workforce. The Association's activities are guided by a Governing Council comprising of industry leaders. The objectives are pursued through various panels within ICEMA that guide the activities of the organisation.

On the policy issues, ICEMA works very closely with various Government Ministries/Departments including Ministry of Heavy Industries, Ministry of Finance, Office of Economic Adviser (DPIIT), Central Board of Excise & Customs (CBEC) and Directorate General of Foreign Trade (DGFT). The association also has strong linkages with other global partners such as AEM (USA), CECE (EU), CEMA (Japan), KOCEMA (Korea) and CCMA (China) etc.

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