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Building a New Model for Power in Asia

By Bill Ruccius

In the early 1990's many North American and European utilities and IPP's came to Asia to help solve the shortage of power generation in the region. They brought a western model with long term contracts that had worked well for them in the West and one with which they felt very comfortable. The contracts had formulas that adjusted the price they were paid for changes in fuel costs, inflation and exchange rates. There were capacity payments or minimum take quantities in the contracts that protected the long term fixed costs which were in the form of capital investment made up of equity and project finance bank loans.

With the Asian financial crisis in 1997 many of these power projects started experiencing problems. Most of the North American and European utilities have gone home and we don't expect them to return soon. They were either disappointed with their business in Asia or had financial problems back home with their core business that they had to solve.

Not enough new project development has been happening since 1997 and there are shortages of generation in many markets in Asia today. Asia has half the world's population with low per capita electricity consumption in the developing countries and some of the fastest growing economies in the world. Without power these developing economies will not be able to grow at the rates that they should. We need to look at our past experiences and see if we can come up with a different model that will attract outside investment in the power sector and be successful. We need to look at what did not work in the past, determine why it did not work and then try to find new ways of apportioning the risks and rewards to make it work for new investments today.

Ability to Pay:
In the early 1990's there were shortages of generation in many developing countries in Asia and they were eager to have foreign investors come and make the large capital investment in new power plants. When negotiating the contracts there was not enough thought put into how they were going to pay for the electricity when the new generation facilities came on line in 3 to 5 years. They were happy to have the investment coming in which spurred their economies and created jobs. The present government looked good today and the payments were a long time away and they would figure it out by then, they thought.

Many of these developing countries had state owned, integrated utilities that were not very efficient. It is not uncommon to have over 50% of the electricity generated lost or stolen. There are often price subsidies for the residential and especially farming customers. If the customer is not paying for the electricity then there is no incentive to conserve and the lights probably stay on 24 hours. It was not unusual for the government itself to be the worst offender for nonpayment. The utilities were had pressed to cover even their variable operating expenses. How were they going to be able to pay the full operating and capital costs of the new generation that was being built by the foreign investors?

Before investment in new generation is even considered, every customer must pay for the electricity and pay the real cost of that electricity. This in not an easy job when people have not been paying at all or were paying a highly discounted prices in the past. People feel it their right to get the cheap electricity in their homes and any government that tries to change that might not be around long. But it must be done or the chances of new generators getting paid are low. Another benefit of every customer paying and paying a real price is that you will probably find that you don't need as much new generation as you thought. When a customer gets that bill every month and knows he has to pay or get the lights shut off he will start paying more attention to conservation and only use what he feels he really needs.

Foreign utilities can help here. They have many years of experience with reducing technical losses and have developed efficient computerized billing systems which can be applied. But purchasing the distribution system has proved to be a very risky business in the past. It is very difficult to put a proper value on the business if you don't know what is going on inside. Often accounting standards don't exist or are not enforced and there is no independent auditing. The financial statement as presented are very suspect and cannot be relied on. Losses are probably much greater and stealing much worse than reported. It might take years of due diligence to find out what the true picture is and no investor would want to spend the money just to put in a bid for an investment that probably isn't worth very much.

I think the answer here is to figure out how to structure a management contract with an option to buy a few years in the future. The successful bidder would be paid a reasonable management fee and would share with the government all improvements in financial performance of the distribution company. The source of capital required for reduction of losses, meter installations, transmission upgrades, etc. would have to be agreed and arranged as part of the management contract. At some point in the future the manager would have the right to purchase the distribution company at a price established by a formula in the contract that takes into account the real value of the company at the beginning of the contract and the value after improvements made by the manager.

I don't know anywhere this has been tried but it certainly would be interesting to try to figure out how to make it work. As stated above it will be difficult to be successful with foreign invested new generation if the customers are not paying and the utility has no money to pay. This is the crucial first step in building a new model for power in developing countries.

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