Andreas Korn and Mechthild Horn

FINANCIAL RESTRUCTURING OF THE POWER SECTOR IN BANGLADESH

Fichtner Consulting & IT AG, Sarweystr. 3, D-70191 Stuttgart, Germany
E-mail: Andreas.Korn@fcit.fichtner.de, Mechthild.Horn@fcit.fichtner.de

Overview

The power sector of Bangladesh is currently undergoing a reform, based on the program laid down in the Government's Vision and Policy Statement of 2000. Broad objectives of the reform policy include economic growth through universal access by 2020, quality supply at affordable tariffs, creation of commercially viable entities, introduction of a single buyer market, promotion of competition and private participation, and transformation to a financially viable power sector. Considerable progress has already been made with sector unbundling, introduction of independent power producers, creation of an energy regulatory commission and corporatization of sector entities, but the power sector is still dominated by public enterprises.

Most of the generation and a large part of the distribution assets belong to the state-owned Bangladesh Power Development Board (BPDB). Reform plans include the conversion of BPDB power stations into corporatized entities and the split of the distribution business into four different corporatized distribution entities; BPDB should also act as the Single Buyer. The Ashuganj Power Station Company (APSC), since 2003 a wholly owned subsidiary of BPDB, is the only generation company that has been corporatized. Transmission and technical dispatch was spun off to the Power Grid Company of Bangladesh (PGCB) already in 1996. Power distribution is the responsibility of several companies: BDPB supplies urban areas outside of the capital Dhaka; the state-owned Dhaka Electric Supply Authority (DESA) supplies the Greater Dhaka area; the Dhaka Electric Supply Company (DESCO), corporatized in 1996 as a wholly owned subsidiary of DESA, serves selected areas of Dhaka; the West Zone Power Distribution Company (WZPDC) took over the electricity supply in five towns around Khulna in 2005; seventy consumer co-operatives supply the rural areas under co-ordination and monitoring of the Rural Electrification Board (REB).

A major driver for power sector reform was the dismal financial condition of the sector. Sector entities have accumulated huge losses and high accounts receivable, and in consequence are unable to service debt and generate the resources for expansion and major maintenance. Direct subsidies to the sector through the Annual Development Program are used not only to finance capital investments, but also to service debt, mainly to multilateral banks and for supplier credits. Reform efforts are already showing results: system losses have been reduced in all entities except DESA, collection ratios have increased, and overall operational efficiency has been improved. Nevertheless, improvements have been slow, and the poor financial condition of the sector remains a drain on public resources, undermines sound sector development and is a serious obstacle to economic growth.

In response to these challenges, the World Bank commissioned Fichtner Consulting & IT in August 2005 with the preparation of a financial restructuring and recovery plan for the entire power sector of Bangladesh. The objective of this project is to define, in co-operation with the Ministry of Energy and the sector entities, a realistic plan to restore the sector's financial viability and creditworthiness within a reasonable timeframe.

Methods

The Consultant's approach to the task of preparing a Financial Restructuring and Recovery Plan comprises five major methodological steps:

(1) Analysis of the financial performance of the sector entities: An in-depth analysis of recent balance sheets and income statements of all sector entities is a prerequisite for the identification of appropriate remedial measures. The assessment of accounting and operational procedures is part of the analysis, as well as the review of plans for future power sector development, such as investment programs and tariff development. Inconsistencies in the data base caused considerable problems at this stage of the project.

(2) Development of recommendations for financial restructuring: Potential measures concern the restructuring of the balance sheets (i) of established sector entities like BPDB and DESA – these need to be relieved of historic liabilities which cannot be paid off from existing resources or future revenue, and (ii) of the emerging power sector entities – these need a financially viable and sustainable basis for future operations.

(3) Development of recommendations for financial recovery: While financial restructuring measures focus on the balance sheets of the companies, financial recovery measures concentrate on their income statements and their earnings potential. Key measures for financial recovery aim at (i) the reduction of the cost of supply, and (ii) the improvement of billing and collection.

(4) Development of an integrated financial model for the power sector: The various possible scenarios for financial restructuring and recovery identified in the previous steps need to be assessed with regard to their financial impact on the sector entities, the state budget and electricity tariffs. This is done with the help of a financial model, especially programmed for this project. The model consolidates the projections of balance sheets, income statements and cash flows of all sector entities, simulates the financial performance of the entities under various assumptions, and calculates relevant financial performance indicators over the next 10 years.

(5) Preparation of the Plan: Finally, based on the results of the financial model, the best solution for the financial restructuring and recovery of the power sector is identified. The recommended measures are described and justified in a Road Map and a time bound action plan.

Results

The recommendations for financial restructuring of the power sector address the following issues:

- Debt service liabilities: All outstanding debt service liabilities owed by the major entities to the government should be converted to equity. This step is necessary to avoid an increase in tariffs which would otherwise be required to generate sufficient revenues for the utilities to pay off their debts.
- Long term loans: The balance of outstanding foreign and local currency loans should not be written off but retained by the power sector entities. The debt should be serviced by the utilities to re-gain the confidence of the lending agencies. This could be done by bundling the existing foreign loans under one subsidiary loan agreement with slightly relaxed on-lending conditions, such as a stretched repayment period and a fixed interest rate.
- Accounts receivable: The end-use consumer accounts receivable should be written-off to a level which can be considered in line with prudent accounting practices. Receivables from government, semi-governmental and autonomous institutions in excess of a six months billing should be set off against debt service liabilities. Balances in inter-company accounts for electricity sales, electricity purchase and wheeling services should also be set off against debt service liabilities.
- Unfunded pension obligations and gratuities: The provisions for unfunded pension and gratuity obligations of BPDB and DESA have to be properly evaluated and audited so that their size can be reflected as liabilities in the balance sheet. Funding of these obligations has yet to be secured.
- Assets: Assets of some entities were valued in 1991; they should undergo a re-valuation before they are transferred to the future successor companies.

Recommendations for financial recovery address the high losses in the distribution system resulting from technical deficiencies, inaccurate and defect end-user meters, illegal connections, theft of electricity, false meter reading and lack of internal controls. Other recommendations concern the poor billing and collection; these are to a large extent organizational problems which can be tackled by the companies at relatively low cost, by controlling the connections within high problem areas, identifying and removing illegal connections, detecting and rectifying tampered meters and meter bypasses, disconnecting non-paying customers, improving customer relations management, etc.

The recommended activities will, however, only have a lasting effect on the financial performance of the sector entities when they are supported by continuing sector reforms creating a favorable commercial environment. Key issues in this context are: (i) improved corporate governance and independence from government control and interference; (ii) creation of an appropriate commercial framework for the power market with a defined set of market rules; (iii) clear definition of the technical and commercial interfaces between the future power sector entities; (iv) gradual introduction of cost-recovering tariffs and reliable subsidy payments from the state budget in the interim period.

Conclusions

Measures for financial restructuring and recovery are required to restore financial viability and creditworthiness of the power sector entities in Bangladesh. Restructuring of the balance sheets alone will not be sufficient to improve financial performance on a sustainable basis – further measures for financial recovery need to be implemented to enhance the companies' revenue generating capacities. Long term success of both types of measures is only guaranteed when they are supported by continuing sector reforms.