Lessons learnt from dabhol project essay sample

Lessons Learnt and exit strategy: What are the crucial lessons of the DABHOL power project for other strategic initiatives in India? How do you address the risk inherent in such enormous global projects? How do you immunize against such risks? If you are proposing a new project of this nature what other strategic, financial and regulatory initiatives would you recommend for such projects to succeed? The crucial lessons learnt from the DABHOL power project are: 1. The dependence on a single buyer is always risky especially when the obligations exceed the capacity of the buyer. The investors should realize the fact that though focus on favorable terms to increase shareholder value is primary they should not ignore the capacity of the buyers. Also it is always better to find alternative buyers before deciding to make such large scale investments. 2. Though MSEB was forced by circumstances to enter into contract with payments in US dollars, it could have hedged the rupee depreciation by using foreign exchange contracts.

3. No matter how much you use risk mitigation tools, if there is fundamental flaw in the techno- commercial evaluation of the project , it is ought to fail. Enron’s vested interests in securing LNG supply lead to high tariff which was not feasible to be paid by the consumers. The project is designed for base load whereas Maharashtra suffers to cater peak load. The take-or-pay PPA did increase the overall average cost by five times which cannot be afforded by MSEB or pass through to end consumers. 4. Lack of transparency, open and competitive bidding and contracting leads to bad deals. The contract was signed DPC with sole negotiation without involving the competitors. There was a lack of transparency and legitimacy among consumers. The politicians exploited the lack of legitimacy for their vested electoral interests.

5. Unethical and corrupt practices make any business proposition unsustainable in the long run. 6. The financial institutions and commercial banks cannot simply rely on the guarantees to fund infrastructure projects. They should have expertise who can understand the techno-economic feasibility of the project before proceeding to fund such large scale infrastructure projects.

7. The history, business, financials, accomplishments, activities and area of operations of counter party must be thoroughly analyzed before signing any contract or agreement. Some of the major risks inherent in such enormous global projects are: 1. Expropriation Risk- Infrastructure project assets are mainly fixed to ground and they provide basic essential services that Governments provide to their citizens. Governments therefore have political justification for taking over such assets. 2. Regulatory or Policy Risk- The sovereign Government can change the tax policies, duties and levies and other charges which may adversely affect the returns of the investors. This kind of risk is very difficult to detect as Government uses its regulatory powers and makes such changes legitimate backed by force of law. 3. Breach of contract-The concentration nature of buyers may encourage paying reducing prices for the output. Such situation may arise due to various economic reasons like currency devaluation, budgetary deficit, and economic downturn.

In such situations the Government cannot meet their obligations and are forced to breach contracts. 4. Political Risk- Risks such as Political Force majeure arising due to events like politically motivated violence, wars, terrorism etc. Some strategies to mitigate the risks in such global projects: 1.

Purchasing products like Political risk insurance which insures losses arising from sovereign holdup risks. Some public insurance providers are Overseas Private Investment Corporation (OPIC), World Bank ' s Multilateral Investment Guarantee Agency (MIGA) Asian Development Bank(ADB), European Bank for Reconstruction and Development (EBRD) etc. 2. High Debt reduces the probability of sovereign holdup since the project has committed cash flows to meet. 3. Alignment with Government objectives- The investors have to understand and align the underlying objectives of the Government in such large scale projects. In Dabhol Power case the Government of India invited foreign investment to improve the ailing Power sector in the country.

The objective of Government is to boost the Power sector which is crucial for Industrial development and GDP growth. But the objective of Enron was to earn unreasonable returns on investments and secure supply contracts of LNG. Hence the project failed. 4. Local Community support- While it is important to gain support and confidence of political leadership at country level it is very important to garner strong local community support. In Dabhol Case the Central Government forced the State government to enter into Contract but the State political parties were opposed to it as exploited the project to their political interests. Same is the case with TATA motors and SIngur where the state government alloweion party exploited d the land acquisition without the support of local community and the opposition party exploited the issue to come into power. 5. Competitive and reasonable returns- While it is natural for the Investors to expect high returns citing high country risk they also should understand that the output prices are positively related with high returns and hence they increase the probability of political risk. Hence it is very important to estimate returns which are fair and reasonable.

Other than these major risks other risks associate with projects can be listed and evaluated by using a Risk Breakdown structure (RBS). The RBS has several categories and sub categories. The investors can evaluate each risk category based on the probability of occurrence, impact and priority and assign weights. The RBS can be used to evaluate both Pre-construction, Construction and Post Construction phase.