# Bridging the Electricity Gap in Maharashtra: An Innovative Engagement with a Middle Income Client

In September 2009, IFC committed its first sub-sovereign loan in the South Asia Region to the state-owned Maharashtra State Electricity Transmission Company Ltd. (MSETCL), India's second largest electricity transmission company. The loan marks an important milestone in the World Bank Group's four year old partnership with MSETCL – a partnership that is supporting the Maharashtra Government's strategy of transforming the state-owned power utilities in order to improve power sector efficiency, essential for alleviating crippling power shortages, in a sustainable manner.

People in Maharashtra, one of India's most industrialized provinces, were unfamiliar with power shortages until about 10 years ago. Over the last decade, however, the growing gap between electricity supplied and demanded has touched almost 4,000 MW, and power outages now range upto 8 to 10 hours each day. With power cuts emerging as the major constraint to growth and fast becoming a source of public dissatisfaction, the state launched a multi-pronged plan to produce more electricity and to deliver it more efficiently to consumers. Power generation and transmission capacity are being doubled over the next four-five years and the state is scaling up some of the innovative approaches it has piloted, such as private distribution franchisees, to enhance commercial and operational efficiency of its vast distribution system.

The state government approached the World Bank in 2006 to support MSETCL, which had been created in 2005 as part of the unbundling of the vertically integrated state power utility. The scale of the challenge was immense – traditionally, transmission lacked adequate investment and managerial focus on project implementation. Despite its recent corporatization, MSETCL lacked necessary systems and skills essential for achieving the objectives set before it by the government - to scale up its annual investment program from its typical US$ 100 million per year, to US $ 1 billion per year for each of the next four years! It was against this background that the Bank-MSETCL partnership for change was launched in 2006.

## A phased approach helped provide a clear vision to Management and employees

The Bank launched its first phase of engagement with MSETCL under a PPIAF-funded vision finalization and business planning exercise. Through a series of World Bank assisted consultations with key stakeholders - employees, customers (mainly the distribution companies), suppliers of equipment and services, state government, state power regulatory authority,MSETCL's Managing Director and its "Change Management Team" took stock of the company's strengths and weaknesses, and the opportunities and threats likely from the unprecedented expansion in transmission investments. Through this process MSETCL developed their business plan and organizational structure to implement the required US$4 billion transmission investment program.

Bank support included (i) assessment of growth in demand, based on which the US$4 billion plan was developed and prioritized; (ii) assessment of MSETCL's implementation capacity; (iii) development of strategic options to leverage the company's scarce financial and managerial resources (relative to the envisaged scale-up), including exploring options for public-private partnership.

**Piloting a 'strategic alliance' contracting framework**

In the second phase, which began in 2007, MSETCL designed a framework for implementing a 'strategic alliance approach' for initial investments of US $1.5 billion. A second World Bank–administered PPIAF grant assisted MSETCL in designing an optimal bidding strategy for selecting a private partner for this priority program and in developing a risk-sharing contractual framework.

The strategic alliance approach – a first for India – hinged on attracting large and technically competent vendors to achieve fast track project implementation as well as reduced transactions and associated costs. It also provided for innovative risk-sharing through a performance based platform As per this approach, EPC partners were selected through open competitive bidding, to assist MSETCL in implementing a bundle of new projects proposed to be undertaken over the next four years. Instead of inviting separate bids for each project in the traditional way, the projects were bundled together into four groups. Each of these groups was awarded to a qualified and competent Strategic Alliance Partner selected through open competitive bidding. Each of the Partners is responsible for detailed design, engineering and implementation of the projects in his group. This process involved forging a fundamental cultural change at MSETCL, which had been accustomed to either executing all investments in-house or through a rather adversarial, tight-control relationship with vendors. The company transitioned to an 'alliance' approach, with inbuilt incentives for both MSETCL and the vendor to co-operate. For instance, incentives for vendors were introduced for early completion of projects and the concept of sharing savings in project costs between MSETCL and vendors introduced. The objectives was to make project implementation more efficient, thereby achieving lower costs, a less cumbersome tender process, faster execution and the development of technical and project management skills within the company. The approach paid off, and MSETCL was able to attract globally-reputed transmission vendors to take up contracts worth around US $1.5 billion in May 2009. The contracts are expected to save MSETCL U$100 million compared with internal cost estimates.

The next key challenge was to ensure that the projects got implemented as designed and MSETCL was able to exercise adequate supervision of all projects and contractors. For this to happen, MSETCL needed to reorganize its processes and adequately deploy its human resources. The business re-engineering and institutional capacity strengthening process was undertaken with support from the World Bank through an Energy Sector Management Assistance Program (ESMAP) and AusAid funded technical assistance project, commonly called 'Organizational Transformation of MSETCL'. The focus under this program is on assisting MSETCL strengthen its institutional capacity for managing public-private contracts, implementing policies to strengthen its own human resources and building sustainable change management practices. MSETCL is now implementing a detailed Project Monitoring & Review Process and a well defined Strategic Communication Framework between the Contractor and MSETCL. This involves major changes in business processes and hierarchies within the organization. Existing roles have been re-aligned and new roles created to manage the new business processes. These revised roles and reporting system have helped create an accountability system that allows empowerment to decentralized staff at field levels, who are in touch with ground level realities. After a year of implementation and continued management support to transformation initiatives, the change is now permeating across employee levels in the organization right from management to field staff.

**Loan from the joint IBRD IFC sub-national finance department**

Meanwhile, a parallel dialogue was initiated, focused on preparing MSETCL for commercial financing, transitioning from traditional sources of financing such as loans from government owned financial institutions and government guaranteed multilateral/bilateral debt. A joint team from the sub-national department of International Finance Corporation (IFC) and the World Bank prepared a loan of US $50 million without any state guarantees. As part of the loan support, recommendations were made for improving corporate governance practices and the development of a systematic framework for addressing environment and social issues. MSETCL appointed full-time directors to the company's board through a competitive process, included independent directors and appointed a non-executive Chairman. The MSETCL board also approved principles that would be underlying its Environment and Social policies and procedures which are currently under development as part of an action plan approved by the board. The project supports the medium-term capital expenditure program of MSETCL, aimed at addressing system bottlenecks, replacing or upgrading aging assets, and handling the expected doubling of electricity generation in the state.

This loan, the first such of the sub-national department in South Asia, was approved by the IFC's Board in June 2009 and committed in September 2009. It has helped MSETCL put in place systems that would be essential as it looks for future commercial borrowing. Since then MSETCL has successfully approached Indian commercial banks for its borrowing needs.

"This project highlights the potential for IFC and the World Bank working together to provide timely and responsive financial and advisory solutions," says Vincent Gouarne, Director, IFC. He added "MSETCL's need for commercialization has been effectively addressed through support for institutional development and commercial financing from the World Bank Group"

**World Bank Group's role as a knowledge partner and a facilitator**

"It has been an evolving journey of partnership, where what now looks like a well-defined phased approach was much more dynamic with each subsequent phase a result of continuous dialogue between stakeholders," says Ashish Khanna, task team leader for the Bank. "While

MSETCL top management was in driving seat all the time, the designated role of the World Bank Group was to provide navigational support."

Subrat Ratho, Managing Director of MSEB Holding Co and the former Managing Director of MSETCL adds, "Through the partnership with World Bank, we got pragmatic and best-practice knowledge advisory that could be incorporated as our own within the specific context of Maharashtra."

**A Model for Other Countries and Regions**

This three-year relationship, involving technical assistance as well as lending, is focused on sustainable change management, through a consultation-driven process owned by the company. Adds Salman Zaheer, Program Director, South Asia Regional Office, "This approach provides important lessons for the World Bank Group in other infrastructure sectors and developing countries, where policy framework has been reasonably defined but implementation aspects of 'how' continue to be challenging".

The transition of MSETCL from a traditional state government department to an efficient and commercial entity is being achieved steadily. The World Bank role in assisting the state government in creating efficiently run sustainable institutions at federal level in India (namely Powergrid and NTPC) is now being replicated at state level. Power sector outcomes like higher generation and system capacity require a long time frame of at least 5-7 years including planning cycle, but the initial results on multi pronged reforms are positive as total peak demand in state of Maharashtra has already risen by 11% from 2006 to 2009.