HOW TO FINANCE ANY PROJECT IN RUSSIA

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1. INTRODUCTION

Project managers and project management experts have historically been involved with projects after the investment decision has already been made. On the other hand owners, investors and bankers frequently do not understand enough aspects of Project Management to organize, plan and structure a project in the most effective manner. In cases when the owner and other participants do not properly structure a project, the financing process can take many months, as questions are raised and additional preparatory work is required.

This problem is most acute in developing economics where project owners and sponsors may not understand (a) financing requirements and (b) project life cycle issues in a market economy. Solutions to the project financing problems require legal and political infrastructure changes, education and different approaches.

This paper presents a very summarized description of one solid approach to project finance, based on the familiar adage of "getting one's ducks in a row". Based on successful real estate development approaches in the USA, the project development process outlined in this paper focuses on major requirements for acquiring financing for viable projects in any industrial sector. In particular, it presents the Project Finance Package (PFP) as the end results of comprehensive project preparation and as the primary means for acquiring project capital.

2. TOO MANY PROJECTS, NOT ENOUGH MONEY

A problem in Russia and many other countries is the overwhelming number of projects in need of financing. Energy, communications and transportation systems need to be replaced, upgraded or expanded. Industrial plants and equipment must be modernized or built up. Organizations should be reorganized and new businesses formed. At the same time major social needs must be satisfied by both government and industry. The well known picture is of "too many projects and not enough money.".

However, much more capital is available for these projects than most people realize. This is especially true for a project owner or sponsor with a need for capital, but who does not know where or how to find financing. In these cases the project owner has various options, such as find a partner with the financing, hire a consultant to arrange financing, obtain money from the government, borrow money at high interest rates, or wait until cash can be generated by normal business activity.

While partners and advisors may be necessary, all of these options may be expensive if the project is not well structured, organized and presented to investors. A basic understanding of financing requirements is also needed.

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3. BANKERS TWO QUESTIONS

Bankers, investors and anyone providing project finance have two main questions about a project:

- o Is the project doable?
- o Is the project worth doing?

For project developers these two questions can be translated as (a) is the project feasible?, and (b) is the project financeable?

The first question is generally answered with a "feasibility study" or "business plan". Feasibility studies are frequently necessary to demonstrate an understanding of the market need for the project and the technical aspects for project implementation. Good feasibility reports will clearly address key technical issues as well as economic justification for the project.

Unfortunately, feasibility studies do not always satisfy the second question asked by bankers. The second main aspect of project financing is related to "risk and return." Investors must be satisfied that their investment will be profitable and that risks are minimized. Projected financial "return on investments" can be shown with straight forward finance analysis. Minimizing risks, however, is a much more complicated issue.

4. THE PROJECT DEVELOPMENT APPROACH TO MINIMIZING PROJECT RISKS

Major risks associated with investments in developing economics include project completion risks, business risks, political risks, currency risks, financial and economic risks, and even personal risks.

Project completion risks can be reduced by adequate project planning, a strong project implementation team of companies and technical experts, and professional project management. Business risks can be reduced by clearly understanding the market (customers), good business plans, experienced managers and operations personnel, and advance sales and contracts.

Political risks can be reduced by obtaining necessary approvals, permissions and authorizations; by establishing positive relations with local and regional government authorities as well as the general public; by establishing contracts and legal assistance; and by purchasing political risk insurance. Currency risks can be reduced by proper planning, minimizing usage of unstable currencies, hedging, conservative budgeting for inflation and devaluations, and by maximizing usage of commodities and non-financial assets.

Financial risks can be reduced by conservative planning, contracts, use of professional expertise, shortening of payback periods, increasing interest rates, and experienced business and project management. Personal risks can also be an issue if crime is a problem or if physical dangers exist in the geographic location of the project. (For instance war zones, extreme cold or hot, projects at sea or underground, etc.).

All of these risks can be reduced with proper insurance coverage, planning and preparation. Only by systematically addressing these risk issues can a project sponsor be assured of financing.

The Project Development approach is therefore based on the following:

- o Complete preliminary project planning.
- o Organization of credible project implementation team, including operations.

- Preliminary agreements, and contracts with all parties involved, including authorizations from government officials.
- Complete financial analysis, including feasibility study.
- Insurance, reserves and contingency plans.

5. THE PROJECT FINANCE PACKAGE

Perhaps the biggest "secret" of project financing is the following:

"Bankers only work with paper"

That is all aspects of a project must be adequately documented for successful presentation to investors. Therefore successful project developers prepare a "Project Finance Package" (PFP) for a project. A complete PFP should include the following:

- Authorizations and documents showing political support.
- Feasibility reports and business plans.
- Descriptive and technical documents.
- Organizational documents.
- Complete financial analysis.
- Preliminary contracts and agreements.

Examples of authorizations and political documents include government decrees, government licenses, contracts or purchase orders, laws or legislative decisions, and management directives.

Descriptive and technical documents include historical documents, business plans, design reports, feasibility reports, studies, drawings, specifications, equipment lists and summary overviews.

Organizational documents include organization charts, corporate documents, annual reports, financial statements, resumes of key individuals, historical documents and founding documents.

Project implementation planning documents include project work breakdown structures, work scope documents, cost estimates, schedule, procurement plans, construction plans, startup plans, preliminary project management plans.

Examples of financial analysis include cost estimates, cash flow projectives, pro-forma financial statements (income statement, and balance sheet), financing strategies and plans, repayment plans and analysis, return-on-investment (ROI)analysis, sensitivity analysis, currency risk analysis and hedging plans, guarantees, collateral and security documents.

Preliminary contracts and agreements can include sales contracts, purchase orders, leases, fuel supply contracts, raw materials and supply contracts, engineering and construction contracts, consulting contracts, investment or partnership agreements, off-take purchase agreements, operating contracts, teaming agreements, and other legal documents.

Finally, these documents must be organized and packaged for presentation and review by potential investors or lenders. A well prepared PFP can not only help win project financing but can dramatically reduce the time necessary to secure financing.

A well prepared PFP not only answers many questions which bankers will ask, but also demonstrates that the project sponsor is well organized, understands all aspects of the project and can proceed quickly with implementation (therefore also reducing the time needed to recover investments and to realize returns).

6. HOW TO PREPARE AND USE THE PFP

Few individuals or organizations can develop a project alone or prepare all necessary plans and documents without assistance. Therefore, from the beginning, a project development team should be organized. The project development team should include the project owner's representative, a project development expert, a project financing expert, a technical expert, a project management expert, and a political/legal consultant. Where several of these functions may be covered by one individual, usually the project development team includes 4-6 people. In addition, the team must include local experts and consultants.

Preparation of the PfP itself becomes a project, with the package of project documents the end result of many planning and preparation activities. A list of necessary documents must be prepared and responsibility assigned for completing these documents. In some cases consultants and contractors must be hired to complete project plans, technical analysis, reports or contracts. Frequently, however identification of the project implementation team can lead to technical experts and documents being provided during project development at little or no cost. For this reason, the organization of a well qualified Project Implementation Team is often one of the first activities by a project developer.

The PFP should be prepared specifically for presentation to investors, banks and financial institutions. It becomes a marketing document. Therefore it must be prepared professionally and it must look good. Frequently project developers spend several thousand dollars just on the binding and reproduction of the PFP. This is less common in developing economics. The important point is to properly package and present the PFP, or all the work and expense of preparing the project might be for naught.

The PFP should then be first discussed, then presented to a very small set of previously qualified potential financiers. This group might include private investors, banks, funds or government agencies in several countries. The qualification process, however, is critical, since presentations can be costly and time consuming. Therefore the project developer must identify potential financing sources which are specifically interested in the size, type and location of the project being offered. In addition, because projects will frequently require both equity and debt financing, a financing consortium should be expected and planned for. Therefore the total project financing requirements should be broken into several parts. This should all be clear in the financial analysis included in the PFP.

7. CONCLUSION

The PFP tells the story of a project. If it is a good story it will sell, the project will be financed. However, preparation of the PFP is not easy nor inexpensive. Generally longer and more complex projects require more time, cost and resources for development. But the same issues apply to all projects.

Other secrets also exist today among bankers and investors, such as

"There is always money for a good project"

and

"There is a lot of money looking for good projects today"

Another secret is that major bankers and financiers around the world know each other. So what looks good to one will probably appeal to others. But for projects that are rejected, the word gets around.

The project development approach and an impressive Project Finance Package can help with the financing of any project anywhere. It may be the best approach for financing projects in Russia.

REFERENCES

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