

BOYADJIAN & ASSOCIATES

PROJECT FINANCE & MANAGEMENT CONSULTANTS

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Boyadjian & Associates is a leading consultancy specialized in Project Finance and Management.

Committed to excellence, totally independent and focused on client satisfaction, Boyadjian & Associates provides strategic financial advice, project development, management and financial arrangement services for investors, engineering firms, building contractors and governmental authorities.

This insight aims to encourage dissemination of project finance and management innovations for development and private sector expansion. The views published in these series are those of the authors and should not be attribute to any governmental entity or its affiliated organizations. Nor do any of the conclusions represent official policy of Boyadjian & Associates or of its Executive directors.

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Necessary Skills & Capabilities for Developers

The project developer/sponsors are those companies, agencies or individuals who promote a project and bring together the various parties and obtain the necessary permits and consents necessary to get the project under way. Often they are involved in some particular aspect of the project, for example, the construction, operation and maintenance, purchase of the services or output from the project or ownership of land related to the project. They are invariably investors in the equity of the project company and may be debt providers or guarantors of specific aspects of the project company's performance.

One of the key success factors of big scale projects is the developer's capacity assessment before beginning development activities. Ultimately, the developer/sponsor must have either the in-house expertise to cover all development tasks, or the capability of forming a team by taking on partners, consultants or additional personnel to cover the gaps.

Project Failure Reasons:

75% of all projects fail at the pre-construction phase because there will be:

- Cost escalation;
- Insolvency of the developer/sponsor;
- Insolvency of the design team;
- Inadequate warranty and building contract provisions;
- Unrealistic cash-flow projections.

The Role of the Project Developer:

Once a developer has honestly assessed their in-house skills, expertise, and capabilities, the next task is defining the developer's role in the development process. In general, the lead developer will act as coordinator in bringing together all parties necessary to complete the development process and managing the overall business of project development. The ability to do such an "orchestration" requires general business development skills and project development skills specifically, which is why these skills are at the top of the list. At a minimum, a developer should possess general business skills and some project development skills. If these two are covered, the remaining necessary skills can be contracted out.

The developer's role in either undertaking or managing each development task area should be clearly defined. The importance of defining these roles before undertaking a project is critical for a developer's understanding of what lies ahead, what resources are at their disposal, and how much out-sourcing is needed and the cost involved. The developer's role can be as follows:

- to establish an in-house project team and provide project management services through design, engineering, construction, and commissioning of the project;
- to mandate consultants to prepare the necessary studies (engineering, financial, legal and market report);
- to present to authorities the documentation necessary for approvals and to acquire the required permits and licences;
- to enter into negotiations with contractors, material suppliers and potential clients and partners;
- to conclude the agreements with assistance of legal experts;
- to secure financing by contributing equity in cash or in kind and by arranging the debt financing.

The support provided by project sponsors varies from project to project and includes the giving of comfort letters, cash injection commitments, both pre- and post completion, as well as the provision of completion support through guarantees and the like. Support is also likely to extend to providing management and technical assistance to the project company. This document presents the critical skills and capabilities necessary for project development.

Knowledge of the Development Process

A project can conceptually be viewed as a nexus of contracts and agreements, which bring together various counter-parties for the sole purpose of creating and operating the asset under consideration. Where such projects are financed on a non-/limited-recourse basis, the usefulness of the project agreements reside primarily in their ability to contractually transfer/allocate risks to participants who are best equipped to handle them. Contractual arrangements between the parties stipulate who is responsible for what. A proposal or bid in which an experienced company has only a

small role is obviously less attractive and more risky than the stakeholders might initially have been led to believe.

Technical Expertise

Sound business practices and management skills with technical expertise related to project engineering, project management and plant operations are important success factors. The strength and experience of the project sponsors are usually the most important criteria. Stakeholders consider not only the internal capacity and financial position of the sponsors, but also sponsors' experience in the industry and country. An important sub-criterion is the experience of the sponsor team in working together on projects – a successful joint track record reassures the other stakeholders. The added value that a given developer may bring to the project may include synergies and a more efficient or effective method of providing the services. Synergies will be achieved if the sponsor already provides such services and therefore has the necessary infrastruc-

Commitment to Time Frames:

Beyond the ability to understand and commit to the capital requirements of project development, a closely related issue is the development time-frames. There are no hard and fast rules on this subject. A development period of one year to reach financial closing would be considered very fast while a development period of two to three years may be more typical for medium size projects.

It is imperative for the developer to establish a realistic time frame for all development tasks including the time necessary to go through numerous iterations of all agreements, technical studies, government permitting, developing bid documents for vendors and EPC firms, investor due diligence, and legal/financial documentation.

In many countries, approval and permits may take a half year each, and cannot be applied for concurrently. Investor and lender due diligence can typically take six months, with documentation taking several months more.

Reaching financial closing always takes longer than anticipated. A developer can take the best time estimate and then prudently double it. The developer must commit to the time frame and have the resources to do so, including unforeseen delays.

ture for implementing the project.

Financial Expertise

Every investment and financing decision involving allocation of resources under uncertain conditions is associated with some risk, which is in effect, either assumed in the expectation of a higher return, or is transferred to others through hedging and/or contracting arrangements. The Developer must be able to facilitate the early investigation into the feasibility of the project and must have the ability to measure, allocate project-specific risks to parties best able to bear them, control performance risk through incentives, and use market hedging instruments.

Connections with Key Parties

Ability to make critical connections and develop relationships with key parties are important during the project development process. Without the right connections, your big-scale project can face a costly dead end. This does not mean that the developers themselves need to be born with such connections; a diligent, smart developer willing to devote time and resources can certainly establish good connections on a deliberate and straightforward basis.

The most common mistake made in establishing connections is that the developer often becomes deeply involved too soon with parties that fail to deliver the promised influence, or are simply a

veiled conduit for corruption. This can lead the developer to a worse position than if it had no connections to start with. As with every other aspect of conducting project development in a foreign country, doing the due diligence on potential partners is vital.

A fair majority of developing countries do not have institutional systems of meritocracy, but rather, they have systems that are divided along lines of political and economic power. Many underpaid bureaucrats have incredible power over several aspects of project development. On the other hand, wealthy individuals or companies may not be able to do anything to move the project forward if they do not have the right connections. At a certain point it is necessary for the developer to form solid relationships with people and organizations that provide a sound and reliable window into the political decision making system. No matter how strong a developer's connections are, if the locals are not behind the project, they can potentially delay or stop a project.

Capital Resources Available

Running out of money to continue project development is probably the most common risk of many small and medium size developers. While development capital from various sources is available, an early stage developer is still required to get the project to a certain stage before such sources of capital will even look at the project. Therefore, a developer must make up a basic

budget required to get the project to a stage where investors, individuals, or other larger developers will either join the developer in partnership, or simply take over the project for a price. The entire cost of development can be from several hundred thousand dollars up to 5% of total project cost of a billion dollar project, or \$50 million.

If a developer lacks capital for the medium or long term, it is necessary to create an accurate interim budget for getting the project to the stage where providers of development capital will take it seriously. If the developer cannot self-fund this interim budget, and cannot rely on associates to do it, it is better of not undertaking development in the first place.

The chances of attracting such investors are decent if the following factors are present:

- The developer gets preliminary agreements in place through its own resources;
- The developer establishes necessary in-country relationships;
- The project's technology is relatively standard;

- The project is located in a reasonably stable country with some form of currency protection, and,
- A minimum after-tax IRR in the 20 – 25 percent range can be demonstrated for investors.

Conclusion

While it is unlikely that small or medium-size developers possess an appropriate level of these skills, it is necessary to have or acquire a basic knowledge of each. Most commonly, a developer will start with at least a sound capability in at least one or two of the categories, and then take on additional employees, or contract out various tasks to third parties. Each time an additional expert is hired, or a new partner taken on, the profit margins begin to shrink.

It is a very difficult business judgment to allocate scarce development cash, to hire consultants, or to give up equity in the project in exchange for expertise or partnering. Nonetheless, there is no way to avoid acquiring, one way or another, the requisite capabilities. Developers often must be willing to lower their profit expectations in order to reach success.

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