




Selecting International Performance Contracting Opportunities

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WANT TO GO "INTERNATIONAL?" ...TAKE A GOOD LOOK

With the approach of retail wheeling, subsequent price volatility and more than a little utility confusion on the horizon, it is a great time to pose the question; why not reach out and become an international ESCO?

There are lots of countries that could certainly benefit from the introduction of performance contracting and the establishment of full service energy service companies. ESCOs from a number of countries are already "testing the waters" around the world. British, German, Austrian, French, and Australian companies, and probably others, are looking for business in areas far from home.

There is no question that international markets can be very favorable targets for an ESCO that is ready to broaden its market base. There is a long list of developing countries: the Central and Eastern European nations, the new nations that once formed the Soviet Union, the "awakening giants" like China, Indonesia and India...all ought to be good opportunities for a growing ESCO to plant the flag of performance contracting...but are they?

The answer is yes...but.

Unfortunately, not all international markets offer a real opportunity. Selecting and evaluating a "target" country is the first, and possibly the most important task facing any firm considering international activity.

There is no "one size fits all" checklist to use in the evaluation of a potential target country. Over the years we have, through trial and error, developed a broad protocol, which goes a very long way toward assembling the data needed to make a reasonably sound decision. No list can remove all the risks, but our protocol removes many of the risks resulting from wrong assumptions. The format we use can be roughly divided into three

broad areas: country analysis, in-country partner potential, and market assessment.

COUNTRY ANALYSIS

If you are serious about entering the ESCO market in a certain country, there are several categories of information that deserve attention; some quite obvious and some rather subtle. There will be overlaps, but these general areas of inquiry provide a way to cross check data and help with interpretation.

Some of what you need to know is readily, and publicly, available...and may even be accurate. Many other key pieces of information need to be developed in a visit to the country in question or through someone designated to conduct your research. This person must have the contacts and/or the local knowledge to get the answers.

First, of course, a careful examination of the economy is crucial to long term contracting; so it is essential to assess the overall economy and the political situation of the country in question. A reading on the stability and philosophy of the government and, in the case of a number of countries, the level of privatization, can be quite easy to get. Much of this can be done "long distance" from sources that are quite readily available.

Beyond this assessment are a number of more subtle "blanks" that need to be filled: What is the real posture of the country's leadership toward trade, the economy foreign-based business activity, energy, etc.? How stable is the political situation and are there important changes in the offing? What are the prospects over the next several years? Specific economic issues such as inflation and interest rates, convertibility of currency, repatriation and general economic trends are all indicators of possibilities/limitations for business success.

All this assessment tells the prospective international ESCO, however, is that the target country might be a possible market and might be worth further effort and expense. How much effort and how much expense remains to be determined. The data beyond the broad facts suggested above become more costly and more subject to interpretation. Each of the initial facts opens the door to more issues, which will require careful examination and "expansion," before an intelligent business decision can be made.

There are other things about the government, the energy situation and the economy, that data from the U.S. Commerce Department and other

sources will not tell you. Does the government policy encourage energy efficiency or do various rules and regulations make it very difficult to get anything done... if you are looking at the market in public facilities, this is a vital question.

This essentially seamless inquiry leads to more basic questions: If we go into this country, what kind of a market will we face? What problems will we have to deal with? What resources can we call on to get the job done? At this stage there is only one certainty; it won't be like home.

The legal systems in some of the possible target countries is not yet really ready to handle some of the "everyday" matters that we take for granted. In some other countries the laws may be solid, but the time frame in which the legal process works makes contract enforcement meaningless. The legal framework in India is solidly grounded in English common law, but the courts are so slow that almost anything can happen. In the new countries that were parts of the former Soviet Union, China and some other countries, the court system, as we would recognize it, still does not really exist and contracts are more than somewhat questionable.

In some of the countries that seem to be attractive targets, the banking system can be a problem. In some of the "transition" economies, banks are still in an organizational phase and not really ready to consider financing of long term projects. In other areas, a "long term" loan is two years or less...and this may be well justified in an economy where the inflation rate is high. In countries where the multi-national development banks (MDBs) have been active, other routes to project financing may be available either through local banks or more directly through MDB programs.

Regardless of official policy, and what is published, it pays to look at whether there is an underlying suspicion or bias against the entrance of foreign businesses, investment or technology. If this exists, the bureaucratic road blocks, all quite unofficial, are almost limitless. Consider that a Kentucky Fried Chicken outlet in Bombay was closed for a time because "flies" (a shocking thought in Bombay) were discovered. It took court action to "un-discover" the flies. Sometimes this sort of thing happens when cultural, local, or regional issues have arisen that stir the political pot.

The energy information not available over the Internet includes the important matter of power availability by region and power quality. In thinking about energy efficiency projects, power shortages in a particular region and frequent outages are critical concerns. This can be a problem or present an opportunity. In India, power outages and wide power quality swings are facts of life. Cogeneration may be an important ESCO offering.

In the Philippines and some Eastern European countries power curtailment is a daily, scheduled, occurrence. Most countries have horizontal stratification of utility services like the U.K. model; i.e., generation, transmission and distribution are separate functions with businesses controlled by the state. A key question arises: who loses when energy efficiency increases?

Utility structures, policies, and attitudes vary by country and sometimes by region. The incentives and/or disincentives that originate with a utility can make a huge difference in the possibilities for successful energy efficiency projects.

How is energy purchased? In Poland where district heating is a big factor, tenants in apartment blocks pay for heat by the square meter; thus, they currently have no incentive for energy efficiency. With energy billed on an area basis there is almost no metering. These two factors have complicated the approach to the district heating market, requiring some very innovative strategies. The size of the market is huge and the efficiency possibilities are almost beyond imagination.

In some countries there is very little accurate metering of any kind. There may be demand schedules, but no time-of-use metering. One very large Indian utility knows when its peak load occurs, but does not know exactly which customers are pushing the top of the scale. Their solution to potential system overload is to call some of their "high tension" customers and ask them to cut their loads.

In India, because of the chronic, and growing, power shortfall, some manufacturing companies have contracted for far more electricity than they need as "insurance" against the time when they need to expand. This can well mean a minimum monthly bill that cannot be changed when energy is saved, without a difficult contract renegotiation...a potentially serious disincentive for an energy efficiency project.

On the economic side, it is important to gather as many indicators as possible as to what is likely to happen in a country (some guesses may not be entirely correct, but they can be important) that will help or hurt the possibilities for an energy service business. Are new taxes in the works, or are there tax breaks that could make a difference? What sectors of the economy are growing or shrinking and what sectors are being propped up by government at an artificial level? Will those props last? And, not incidentally, how do people feel about the economy. If people are optimistic they are far more apt to be ready to accept new ideas and approaches which help them take advantage of energy opportunities. Perception is often as important as reality.

IN-COUNTRY SUPPORT

If an ESCO is going to do business in a new country it needs to know what resources are available in terms of technical capabilities, business alliances, financial resources and markets. In most transitional and developing countries there is an abundant supply of technical people as well as technically capable companies, willing to work, and well qualified to be involved in energy efficiency projects. The “software,” the knowledge about the business side of energy efficiency, is lacking. The concept of full service energy service companies is new, as is the whole idea of energy performance contracting.

In other countries the problems may be quite different. The level of technical capability is more limited. In many instances, the technology they are most familiar with and the systems they have been dealing with are of the '50s level. The concept of a full service ESCO is readily accepted. But the business approaches we learned almost at birth are new and often thoroughly misunderstood. The language barrier can be far greater than the difference between English and Hungarian. Terms such as “return on investment,” or even “profit” are very new in some of the former communist countries, and not at all well understood. Some times they talk the jargon, use the business terms we are familiar with, but their understanding is seriously narrow. In such cases, a “foreign” business man in an unfamiliar country can make some very dangerous assumptions.

These matters make a difference when you are trying to set up a deal. In some Central and Eastern European countries there is enthusiasm, but often too little understanding about how to move ahead. It is easy to forget that for fifty years, forward motion was strictly by permission, not initiative.

All this implies there is a level of training, both business and technical, that will probably be necessary before any solid business begins to flow. There will be a time lag before positive financial results. Always longer than expected. Understanding the technical and business sophistication available within a target country is one more important step before major decisions are made.

IN-COUNTRY PARTNERS

Generally, it makes sense to go into a new market with some local help. A joint venture with an in-country partner or at least a strategic alliance with

a well established firm is a must. A careful census of who is in the energy business and what they are doing is an important part of the data collection effort.

It is fairly simple to find out who is in the energy efficiency business within a given country. Engineering or mechanical contracting firms, who do turnkey energy projects and in some cases, savings based projects, exist almost everywhere. In addition, thanks to the efforts of the U.S. Agency for International Development, quite a number of consultants offering energy audits are available. These may be likely competitors, or present opportunities for joint ventures or alliances. At the very least, they are apt to be the people an ESCO will need to count on for installation and operational help.

Discussions with a few of the firms in energy related businesses will quickly reveal what is happening in the efficiency market. Be aware, their definition of what an ESCO is, and what it does, will probably vary tremendously from U.S. views. Frequently the concept of performance based projects is quite "foreign."

The criteria our firm has established as a way to judge the qualifications of a potential in-country partner are not very different from what you would use to select a partner close to home...with some important differences. Along with the technical capabilities and the strength required for project implementation and follow through, you will need a partner that is capable of navigating the regulatory maze of that country. It helps if the in-country partner has been privatized (or is being privatized). They also need to understand some basics like real costs, return on investment and the need for profit. These qualities are sometimes harder to find than you might think, particularly in those countries still trying to find their way out of a command and control economy.

An effective in-country partner will also know where, and how to acquire and/or import material and equipment you may need as projects move forward. They should also know how to deal with the codes and standards that are the pride and joy of any bureaucracy. Local knowledge of the availability, and quality, of sub-contractors that will frequently be needed is a resource that you cannot bring from home.

MARKET ASSESSMENT

Selecting a target market within a new country, and identifying opportunities within that general market, is a little more complex than it is

at home. The abundance of statistics that are readily available in the United States or in most Western industrial countries is frequently rudimentary or non-existent. This lack of data extends from a good estimate of the energy requirements relative to production levels to the credit information that your financial people will want to talk about. The information generally exists somewhere, in some form, but it will often require extensive research in-country to get it. It is seldom available in neatly written form.

An ESCO contemplating an international move should first consider where its strength lies. If you know a lot about a specific industry, look at that one first.

There are some basic things that will determine whether a particular industry or market is worth consideration. What industry segments are apt to be viable over time... heavy equipment plants in certain Central and Eastern European countries are so obsolete that there is little chance they can survive at all without a long term (and unlikely) flow of subsidies. The state of privatization in that industry and/or the level of government subsidies for the industry are key issues. Too large a percentage of the industrial facilities in countries that are moving toward a market economy, which have not yet been privatized, are “buggy whip” manufacturers that will never survive on their own. Not good targets for long term energy efficiency projects.

The “flip side” of the privatization issue involves those facilities which are apt to remain under state control but may be quite viable as targets for energy efficiency. These are public institutions such as hospitals, schools and other public facilities and industries “vital” to the government. In some ways these present the most stable, least risky, opportunities...they will be there over time.

Is the industry growing or is it declining (or perhaps dying out)? Who is investing in the industry or specific companies within the industry? If outside money is flowing in, it suggests that someone else has confidence in the long term viability of the industry. Within an industry, companies that have attracted substantial outside equity participation may be particularly attractive targets for energy efficiency work. Their management is apt to have a better appreciation of costs as well as the importance and advantages of increased efficiency.

There are great opportunities out there in the wide, wide world. They are accessible and can be very profitable if approached with open eyes, great care and plenty of patience. It is necessary to accept from the start that doing business in India, China, Slovakia, Brazil or Ukraine will not be the same as

doing business in Kansas or California. Assume that many of your assumptions about those countries will be wrong. You will find good people in every country, who are eager and well qualified to work with you, but you may find that local conditions, culture or political realities make a business venture an unacceptable risk.

There is a world of opportunity for an ESCO that takes the time to do careful, thorough "homework." An in-depth investigation of selected countries with limited risks can allow you to bring together the ingredients that lead to success.

ABOUT THE AUTHOR

Mr. James C. Hansen is president of Kiona International, Inc., an international management consulting firm based in Annapolis, Maryland, specializing in energy matters including the arrangement of performance contracts, location of financing, feasibility studies and training.

He is also executive vice-president of Hansen Associates, Inc., a domestic company, which focuses on energy issues with complementary consulting services in management and communications.

Jim directs the firm's work in Asia, where he has investigated more than 50 Indian firms as potential ESCOs, taken American ESCOs to India and brought an Indian delegation (potential ESCOs and bankers) to the U.S. to visit performance contracting sites. The firm is also active in China as consultant to the government of the Peoples Republic of China.

Jim has conducted an assessment of the feasibility of performance contracting in Hong Kong and south China and authored an options paper for the Hong Kong Productivity Council on the various business opportunities the HKPC might pursue in performance contracting.

Prior to joining Hansen Associates in 1985, Jim worked for 21 years with The Dow Chemical Company. While with Dow he was involved with media relations, product publicity, government relations, emergency management and community relations. He also worked on the communications projects of the major trade associations representing the chemical industry.