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Role of Project Finance in Emerging Economies

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Abstract
The steady growth of funding projects with project finance to develop and provide infrastructural facilities in developed and emerging economies cannot be overemphasized. This study analysis and reviewed the immense contribution of project finance schemes in constructing numerous public projects. Central to the success of this scheme is the non-recourse financing of projects, allocation and shifting of project risk between the parties of the scheme. The study further found that in spite of the complexity associated with project finance is emerging economies, it is prudent to formulate a very solid and suitable legal framework, provide enabling environment for investors to reap their investments and a stable political atmosphere considering the number of years required to recoup the initial cost of investment.
Keywords: Project finance, emerging economies, legal framework, investors, infrastructure.

1. Introduction

In the light of basic developmental expectation from most governments, contemporary governance in most economies has shifted focus on developing large scale projects through the application of project finance schemes (Esty, 2004; Andrews, 2010; and Grahame, 2001). In the last few decades, the number of project finance schemes employed to provide basic infrastructure for public consumption has increased considerably (Fight, 2006). In the United Kingdom alone, a total of 600 projects worth over £56 billion have been constructed over a period of 15 years through project financing (PPPForum, 2011). Globally, the total cost of financing infrastructure through project finance schemes increased from $208 billion in 2007 to $219 billion in 2010 (Thompson, 2010). As a virtue of fact, the role played by project finance schemes in most economies is very significant to their development especially the emerging economies (Esty,
2004). To assess the key roles played by project finance in most economies, the main intent of this study is to analyze the general overview of project finance, and its significance to most economies. The study further aims at examining and describing the major parties to a typical project finance initiative.

1.1 Overview and Role of Project Finance in an Economy

In lieu of using the traditional means of financing projects in corporate finance, project finance schemes has over the years yielded positive results in constructing long term projects without necessarily having sufficient funds (Esty, 2004). Project finance involves the financing of an independent economic unit, legally created with funds from one or more parties/firms. This type of financing is a non-recourse debt which offers the project company concession to offset the debt with the cash generated from the project after completion. In actual fact, the assets of the project company serves as collateral for the loan accessed (Yescombe, 2002). In such schemes, a legal company is created with sponsors and other financiers mandated to complete the purported project. These parties' ranges from project sponsors, governments, contractors, financiers, and suppliers (Fight, 2006). The major source of finance under project finance schemes are normally accessed from trade finance, commercial debts, export credits, leasing mechanisms, subordinated debts and equity (Graham, 2010). Significantly, each project has a unique profile apparently; each individual risk can easily be allocated and distributed wholly or partially (Graham, 2010). Project finance schemes are usually designed to reduce transaction costs especially those arising from inadequate information on possible investments and capital allocation (Stefanie &Versteeg, 2003). It isnormally suitable for funding long-term and specific capital intensive projects such as construction of energy plants, energy supply, telecommunication, airports and harbors, railway systems, tunnels and bridges, chemical and petro-chemical wastes (Yescombe, 2002).

2.0 Significance of Project Finance

The significant role played by project finance in most economies has enhanced the provision of basic physical amenities in contemporary governance (Stefanie &Versteeg, 2003). In most emerging economies, governments sponsor most projects using desired method of project financing such as BOT, thus "Build Operate and Transfer"(Esty, 2004; Ghersi&Sabal, 2005). This system provides an interface between most governments and the private sector/international organizations where these organizations construct and operate the project within a specified period after which the project is transferred to the sponsor/government. As a result of this unique feature of project finance schemes, the volume and number of this scheme has witnessed considerable increase in most African and emerging economies (Thompson, 2010). In 2010 alone, Russia, Brazil, China and India have signed over 200 non-recourse finance deals worth over $130 billion. With the aid of project financing, Brazil financed the construction of Jirau Hydroelectric dam estimated at $5.4 billion in 2007. Similarly, India had accessed funds through project finance to develop the Mumbai metro 2 and the 3960mw Krishanpatnam Ultra Mega Power Plant at an estimated cost of $3.6 Billion. Taiwan's $13 billion high speed railway linking 345 km is one of the world's largest project finance schemes. In whole, the specific regions in the continent (Africa, Europe, Asia, Pacific and the Middle East has benefited tremendously from project finance. The table below shows the value of projects financed through project finance schemes globally as at the end of the period 2010.

Exhibit: Regional allocation of project finance Transactions

Region	2010 US$million	Percentage (%)
Americas	25,534.50	12.27
Asia Pacific	98,708.30	47.42
Europe/Africa & Middle East	83,931.20	40.32
Global Total	208,173.90	100.00

Source: Thompson Reuters Project Finance International (2010)

The immense contribution of project finance in these regions is highly predominant in the energy and power sector. This sector alone constituted 35.21% of the total cost of projects funded through project finance schemes as at 2010. This ratio is followed by the transportation sector that represents approximately 25%, Oil and Gas, Telecommunication among others. Sectorial contribution of project finance globally is given in exhibit 2 below:

Exhibit 2: Global sectorial representation of Project Finance

Sector	2010 US$million	Percentage (%)
Energy & Power	73,300.40	35.21%
Transportation/Railway	52,315.20	25.13%
Oil & Gas	25,950.80	12.47%
Public Properties	13,824.20	6.64%
Telecom	13,382.70	6.43%
Petrochemical	11,306.40	5.43%
Mining/Industry/Waste & Recycle	18,223.30	8.80%
Agriculture	86.30	0.04%
Total	208,173.90	100%

Source: Thompson Reuters Project Finance International (2010)

3.0 Project Finance Initiative (PFI)

Usually referred to as private finance initiative (PFI), project finance initiative is another means of procuring infrastructure by the public sector (Parker, 2012). The United Kingdom is one of the countries that have capitalized on the immense benefit of PFI to develop most of its infrastructure (Fight, 2006). This financing scheme was introduced in the early 1980's in the UK and fortunately has the support of all the political parties. In recent times, the United Kingdom has developed over 860 PFI projects worth over £239 billion (Parker, 2012).Under the project Finance Initiative (PFI), the public sector engages the private sector in a long-term contractual arrangement to design, build, finance and operate projects in the health sector, educational sector, housing sector, and general infrastructure (Parker, 2012). The scheme permits the private sector construct and operate the project for a specified period of time usually over 25 to 30 years. Central to the concept of PFI is the allocation of project risk to the private sector. Notable among these risks are cost overruns, delays, management inefficiencies (Fight,2006; Yescombe, 2002; Parker, 2012). In essence, PFI's aims at encouraging innovation and good design, efficient management and maintenance of assets, enhanced productivity and quality service delivery unlike the conventional public funded projects.

3.1 Major Parties to PFI

The core parties to Project Finance Initiatives are government agencies, project company or contractor, financiers and the Treasury (Fight, 2006). The governments' agencies are the specific public departments that engage the private sector to design, build, finance and operate the project (Yescombe, 2002). These public authorities normally seek approval from the central government to engage the private in such arrangements. The project company is made of the private organization or a consortium of companies engaged to accomplish the project (Parker, 2012). The financiers on the other hand are the financial institutions such as banks and lenders that advance funds towards the development of the project. In essence, the government agency(s) engage these private companies together with the banks that financesthe project in a typical PFI's.

4.0 Conclusion

The critical interrogation of projects financed with project finance schemes and PFI clearly shows that these schemes has contributed immensely to the development of developed, emerging and developing countries however, the operational framework for these specific economies requires further scrutiny. In the developed countries, individual banks have adequate funds to finance such schemes but the same cannot be labeled at the emerging countries. As a result, most of the developing countries depend on international financiers and donors such as the IMF, IFC and the World Bank to provide finances. This tendencies makes the facility less expensive however, other strict requirements may be difficult to meet. It is further argued that PFI's accumulate liabilities on future generations. Notwithstanding all these setbacks, project finance schemes and PFI's continue to be the panacea for funding the creation of projects in most emerging and developed economies globally.

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