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Why Project Funding Must be Considered Earlier in Project Development for Owners

Many owners of large projects consider project financing to be a somewhat independent exercise from project development, often delegated to the finance department. However, our experience shows that financing participates deeply in project strategic development. In addition, it is essential to avoid delays in final investment decisions due to financing issues.
In this White Paper we explore best practices in the field of project financing from the perspective of overall project development.

Introduction

Most large and complex projects require some financing setup beyond the main owner's internal resources, and external funding is actually an increasing trend for major infrastructure and energy projects. This financing can take many forms and lead to setups of various degrees of complication, and will include a combination of the following:

Financing is an integral part of project definition and project financing must be integrated within the project team. Also, it has to be considered early enough

- International / multilateral institutions financing (development bank for the continent or country)
- Export Credit Agencies
- Capital-level financing: partnerships, financial market/market introduction of ad-hoc project entity, private equity
- Debt: commercial banks, etc
- Government subsidies and tax rebates
- Future client funding (may include a production take-off commitment)

Financing does influence project development and later project execution at several levels:

- Governance setup
- Project definition and execution plan (due to financing and cash release conditions)

Many owners being focused on the technical and project management aspects of project definition tend to start the setup of project financing relatively late, however, our experience shows that this often creates substantial performance issues for the project.

Influence on the governance setup

Whoever contributes substantially to the project financing will want to have a say at governance level. Hence, the more complicated the financing arrangements are, the more convoluted the governance setup can be expected to be. While it is understandable that all major financing stakeholders contribute to the key decisions such as the Final Investment Decision, the governance setup still needs to be effective and, in particular, allow timely decision-making (without unnecessary delay) to support the project and exploit the opportunity. Thus, while the key governance body needs to remain small to be effective, there is often a need to setup a number of information committees for major stakeholders to ensure proper information and alignment. In any case, the owner needs to stress the need for the governance setup to remain effective enough.

Influence on the project execution

The following table summarises the impact of financing on project execution depending on the type of financing (which may be combined for a single project):

Type of financing	Typical Impact
International institutions	Audit requirements, early impact studies (e.g. Environmental and social impact assessment study) Specific deliverables and reports Possible local content requirements for economic impact Stringent drawdown mechanisms
Export Credit Agencies (ECA)	Obligation to source equipment or services from the ECA country Foreign currency exchange impacts
Partnerships	Governance Mix of teams, possible impact on sourcing, operatorship etc
Financial market / IPO	Stringent reporting & disclosure requirements, legally enforced including for governance and director's accountability
Private equity	Reporting & disclosure requirements, governance Possible interference in operational management aspects
Commercial banks	Significant cost leading to schedule pressure Reporting requirements, compliance to covenant limits Strong preference for EPC Lump Sum contracts
Subsidies, tax rebates	Obligation of Return on Investment/benefits demonstration to government agency
Future client	Adaptations of product to market expectations Influence on ramp-up and production target Contingency planning for delayed or lower than planned production

Best timing for setting up the financing framework for the project

The influences discussed above show how essential it is that all those aspects are considered early enough in the project, and latest during Detailed Feasibility Study (DFS) (also called Bankable Feasibility Study). Delaying the setup of financing to the back end of this phase will necessarily create a delay and a time gap prior to Final Investment Decision.

While all detailed parameters of financing can only definitely be fixed at Final Investment Decision on the basis of the best CAPEX and OPEX estimates at that stage, the general strategy and principles of financing, associated governance, and adjustments to the project execution strategy must have been considered during the DFS stage. Hence it would be useful to have, at least, agreements in principle with the major financing contributors at the start of the DFS phase.

Integration of financing as part of the project definition team

Moreover, the strong influence of financing on the project shows the importance of that function being represented in and actively participating in the integrated project team during the project definition phase. Project team integration at that phase is known to be strongly correlated with project success. Hence, it is appropriate to integrate financing inside the project team.

Most organisations, however, consider that financing is something special that has to be done at some other levels in the organisation (inasmuch as there is a strong link with the organisation overall strategy and financing capability). This is not adequate when considering a major project. While strong links need to remain with the strategy, business development or finance departments, it is essential that financing leads be integrated in the project team at least during DFS stage and, if possible, earlier.

Actually, project financing is a specialty by itself and there is an increasing trend of specialisation of professionals in this area, replacing more generalist finance people, and they expect to participate in project teams during the project definition stage.

Summary

Project financing is an increasingly important topic for large industrial projects. Many owners consider this to be an independent exercise that can be performed in parallel to project development. However, it is an integral part of project definition and project financing must be integrated within the project team. Also, it has to be considered early enough; we recommend the overall financing strategy to have been set prior to embarking into the Detailed Feasibility Study (DFS) phase, even if the final parameters will only be set at Final Investment Decision (FID).

