Limited Success

Revisiting the distribution franchise model

Distribution franchise (DF) is neither a new concept in India, nor a popular one. It has been a decade since the first franchise was awarded in 2006 amid a lot of promise, and yet, there are only a handful of DFs operating in India. Currently, only five states have operational DFs, namely, Maharashtra (Bhiwandi and Nagpur), Bihar (Muzaffarpur, Bhagalpur and Gaya), Uttar Pradesh (Agra), Odisha (14 divisions) and Rajasthan (Kota and Bharatpur).

The DF model's genesis in India came about in the context of improving access to electricity for the rural communities. This model was given formal recognition with the passage of the Electricity Act, 2003, as a means of encouraging private participation in the power distribution segment, besides improving electricity access. The act empowers a licensee (or franchiser) to appoint a distribution franchisee (without any regulatory approval) to distribute electricity on its behalf, in a part of its service area. The prime motive behind introducing DFs in rural areas was to improve electricity access in view of the limited reach of the utilities. In urban areas, it was driven largely by the need to reduce aggregate technical and commercial (AT&C) losses.

Over the past 10 years, various utilities have attempted to adopt different versions of the DF model. While a handful of them are operating successfully, some remain to be awarded, some were aborted at the bidding stage, and others were terminated due to various challenges like non-payment of dues. The DF models have also evolved from being merely collection-based to input-based franchises, input-based franchise-incremental revenue sharing (IBF-IRS), and input-plus-investment-based franchises.

There has been only limited activity on the DF front over the past few years. However, the model has attracted attention again with

the recent franchise awards in Rajasthan. In this backdrop, *Indian Infrastructure* takes a look at the DF experience so far, the various models that have been adopted, the performance of some of the franchises, the challenges faced by them and possible solutions.

Experience so far

With significant potential, Bhiwandi was awarded by Maharashtra State Electricity Distribution Company Limited (MSEDCL) to Torrent Power Limited (TPL) in 2007 – the first urban franchise to be awarded in India – for a period of 10 years. The issues faced by the area then included a high level of losses, mandatory load shedding, poor collection efficiency, distress load shedding, frequent breakdowns/tripping, unreliable power supply and a large number of unregistered and unmetered consumers.

The franchise has shown exemplary performance with a reduction in the AT&C losses in its area by over 35 per cent, from 61.3 per cent in 2006-07 to 25 per cent in 2015-16. The losses had, in fact, gone down to about 18 per cent in 2011-12, but increased subsequently mainly due to a decline in collection efficiency pursuant to an agitation by consumers against the tariff hike in the state. TPL has already submitted an application for renewal of the franchise agreement (which is due to expire in January 2017) to MSEDCL and the response is awaited.

Inspired by the success of the Bhiwandi franchise, other states such as Madhya Pradesh, Uttar Pradesh, Odisha and Bihar also pursued the idea of implementing the DF model. TPL has also been operating as the franchisee for Agra in Uttar Pradesh since 2009.

Essel Utilities Distribution Company Limited has been operating as a distribution franchisee in two circles – Nagpur in Maharashtra and Muzaffarpur in Bihar since 2011 and 2013 respectively. The company caters to over 800,000 consumers in the cities together.

In the Nagpur DF, AT&C losses have come down from 32.5 per cent in 2010-11 to 17.5 per cent in 2015-16. In Muzaffarpur, the losses have declined by more than 25 per cent since the takeover in 2013. According to Pankaj Thapliyal, president, Smart Utilities–Essel Utility Operations, the improvement in the performance of the two franchise areas has been achieved with the help of various initiatives undertaken by the company, such as installation of smart meters, increase in the number of collection centres and facilitation of online payment of electricity bills.

The Central Electricity Supply Utility of Odisha implemented the DF model in 14 divisions under its licensed area in 2013. These are being operated by three companies – Enzen Global Solutions Private Limited (six divisions), Feedback Electricity Distribution Company Limited (FEDCO – four divisions), and Shyam Indus Power Solution Private Limited (four divisions). These franchises have been awarded for a five-year term, to operate on the IBF-IRS model.

Due to the short term of the franchises, performance improvement has been a challenging task. Nonetheless, losses have declined by 4-15 per cent in these areas during the first three years of their operation.

The overall AT&C losses have reduced by over 15 per cent in the four divisions served by FEDCO. From 45-60 per cent in 2013-14, AT&C losses declined to 35-50 per cent in 2015-16. This has been a result of the various innovative practices that have been undertaken by the company, including the use of software for network planning, GPS-based survey of the low tension (LT) network, installation of GPRS-based spot billing machines, real-time photo-based meter reading, the establishment of 24x7 customer care centres and the introduction of a web-based application for new service connections.

Meanwhile, quite a few franchises have been suspended during this period. Two franchises in Maharashtra-Aurangabad (GTL Infrastructure) and Jalgaon (Crompton Greaves Limited) were terminated and taken over by MSEDCL in 2014 and 2015 respectively, owing to non-payment of dues by the franchisees as per the DF agreement.

In Kanpur, Uttar Pradesh Power Corporation Limited (UPPCL) had appointed TPL as the distribution franchisee in 2009. However, after being unable to hand over the distribution network to the franchisee for over six years owing to resistance from power employees, UPPCL finally cancelled the agreement in June 2015. Similarly, operations could not commence in Ranchi and Jamshedpur, where CESC Limited and Tata Power were appointed as the respective franchisees by Jharkhand Bijli Vitaran Nigam Limited (JBVNL) in December 2012. After major delays, the agreements were finally annulled by the utility in May 2015.

Following the cancellation of the franchises in Ranchi and Jamshedpur, in July 2015, JBVNL invited bids for the allocation of franchises in Ranchi, Jamshedpur, Dhanbad, Dumka, Giridih, Hazaribagh and Medinagar. However, no progress has been made so far for their allotment. The bids invited by Ajmer Vidyut Vitran Nigam Limited in December 2015 for the award of the franchise for Ajmer city also remain pending.

After a hiatus of almost three years, in May

Operational franchises in India

Discom	Circle/Town	Distribution franchisee	Type of franchise	Year of award
Maharashtra State Electricity Distribution Company Limited	Bhiwandi	Torrent Power Limited	Input based	2006
	Nagpur	Spanco Nagpur Discom Limited	Input based	2011
Dakshinanchal Vidyut Vitran Nigam Limited	Agra	Torrent Power Limited	Input based	2009
North Bihar Power Distribution Company Limited	Muzaffarpur	Essel Vidyut Vitaran (Muzaffarpur) Limited	Input based	2013
South Bihar Power Distribution Company Limited	Bhagalpur	SPML Infra Limited	Input based	2013
	Gaya	India Power Corporation Limited	Input based	2013
Central Electricity Supply Utility of Odisha	14 divisions*	Enzen Global Solutions Private Limited, FEDCO, Riverside Utilities Private Limited (RUPL)** and Seaside Utilities Private Limited (SUPL)**	IBF-IRS	2013
Jaipur Vidyut Vitaran Nigam Limited	Kota	CESC Limited	Input-plus-investment	2016
	Bharatpur	CESC Limited	Input-plus-investment	2016

** Nimapara under SUPL; City Electrical Division (Cuttack), Athagarh and Salipur under RUPL; Khurda, Balugaon, Puri and Nayagarh under FEDCO; and Kendrapara Divisions I and II, Jagatsinghpur, Dhenkanal, Talcher, and Angul under Enzen*

*** Subsidiaries of Shyam Indus Power Solution Private Limited*

Source: Power Line Research

Distribution franchise models

Franchise model	Key characteristics
Input-based	- Long-term contract of 10-15 years
	- Franchisee pays an agreed price to the utility for each unit of electricity procured and retains the collected revenue
Input-plus-investment-based	- 15-20 years contract to cover initial investment costs
	- Franchisee pays the utility for each unit of electricity procured and retains the collected revenue
	- Specified investment to be undertaken by the franchisee
IBF-IRS	- Short-term contract (five years)
	- Input energy delivered to DF without payment
	- Incremental revenue realised beyond the baseline is shared between the franchisee and the utility in the ratio as per the contract
	- Both the franchisee and the licensee to incur capital expenditure as agreed

2016, two franchises in Rajasthan – Kota and Bharatpur – were awarded to Kolkata-based CESC Limited by Jaipur Vidyut Vitran Nigam Limited. The company started operations on September 1, 2016. These are input-plus-investment-based franchises, awarded for a period of 20 years. CESC won the franchise by offering the highest rate of input power at Rs 4.26 per unit.

As per the franchise agreement, CESC is required to undertake an investment of about Rs 2.15 billion in the two DF areas during the initial period of five years. CESC is, however, working on a detailed capital investment plan. Aniruddha Basu, managing director, CESC Limited, is confident of the company making an effective contribution as a franchisee with its vast experience in running a distribution utility. "The initiatives planned for Kota and Bharatpur include exercising tighter control on the meter-to-cash cycle, thereby enhancing billing and collection efficiencies, adopting measures to reduce technical losses further and implementing anti-pilferage measures. All these, however, can only be effective if we earn credibility, for which we are sparing no effort. We will make it happen by taking customers along with us," he says.

Issues and challenges

The desired implementation of the franchise model has been constrained by various factors. The bid structure does not provide adequate economic benefits to the bidder. There is a huge gap between the actual and projected parameters defined in the bid proposals. The DF contracts also lack an extension clause and hence, do not provide any incentives for continued investments in the network. Shrirang Karandikar, chief executive officer, India Power Corporation Limited, believes that if the government does not provide sufficient margins and adequate cooling time for reducing AT&C losses after the takeover, it will be very difficult to attract players to this segment. The company has the DF for Gaya.

The DF agreements mandate the franchisee to undertake capital investments in the initial years. According to Devtosh Chaturvedi, managing director, FEDCO, in their quest to be profitable, distribution franchisees need to balance their focus on operational efficiency with the investment of more capital. "If they focus on capital expenditure, they may not have the funds for improving their day-to-day operations and vice versa."

With regard to capital investment, there are various provisions for financial support from central government schemes. The available funds can be utilised for investment in the franchise areas as well. However, the support has not been extended to the franchisees in many cases. Another challenge is that of the unpredictability of socio-political events or natural disasters that may affect the franchisee's operational plans.

The way forward

Going ahead, there is a need to look beyond the franchise models already adopted. Anish De, partner and head, KPMG, suggests that a model allowing for power purchase at competitive rates from external sources should be explored in view of power purchase costs being the largest cost element for franchisees.

Tata Power Company Limited suggests a different mechanism to overcome the shortcomings of the existing models. As per its suggested scheme – Delta Advantage – specific parameters can be identified along with the targets required to be achieved in a given time frame for any distribution circle. The proposal under this scheme may be initiated by any private operator and not necessarily the distribution licensee.

The experience with the DF model has been mixed, with more cases of failure than success. Although the Electricity Act, 2003 has included several provisions, including the DF model, to encourage private participation in the sector and bring in competition and transparency in the sector, this form of limited involvement has not succeeded due to legacy problems in the sector. Challenges like inadequate profit margins, unattractive bid structures, unfair allocation of risks between the licensee and the franchisee, and inflexibility in operations, need to be addressed.

Net, net, the adoption of the DF model has helped distribution utilities improve their performance, as is evident from the experience so far. The model also offers a good business opportunity for private players. In the current scenario, with the high level of AT&C losses, mounting regulatory assets, and initiatives like the Ujwal Discom Assurance Yojana and the Integrated Power Development Scheme, the DF model is certainly one of the more relevant solutions to the distribution segment's woes.

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