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Despite significant increase in private investment in the power sector in Maharashtra over the past two decades, electricity distribution to the end consumer continues to be the weakest link in the value chain, says a World Bank report.
While overall bank lending to the power sector stood at Rs 4,883 billion in FY14, higher than overall bank credit to other infrastructure, lenders to the sector have chosen to lend even in the face of continued inefficiencies in the distribution segment.
 More Power to India: The Challenge of Distribution , presented in Mumbai today is a review of the Indian power sector across key areas of access, utility performance, and financial sustainability. The study, conducted at the request of the Government of India, recommends freeing state utilities and regulators from political interference, increasing accountability, and enhancing competition in the sector in order to move it to a higher level of service delivery. It calls for a transition from administratively run to commercially run utilities.
The power sector in Maharashtra has done relatively well when compared to other states. In 2013, the peak deficit stood at 8 percent and the energy deficit at 2 percent while elsewhere (e.g. in some southern states) the peak deficit was as high as 10 percent. The average per capita annual electricity consumption in Maharashtra was 1204 kWh in FY12 while the national average was only 971 kWh. The state has managed to plan its procurement well with only 5 percent of power purchased through short term sources as against a national average of 22 percent. There have been timely and adequate tariff revisions; generation and transmission companies have been earning profits. However, there is scope for improvement electricity bill collection rate is low at 91 percent and ATC losses were 22 percent in 2013, in spite of the consumer mix being dominated by industries and commercial users, the study says.
In Maharashtra, private investment has made significant contributions to the power sector. In generation, the private sector accounts for around 50 percent of the total installed capacity. There are 8 transmission licensees and multiple distribution licensees.
Bhiwandi in Maharashtra, a textile hub of the country, is a success story of good management of power distribution. Bhiwandi was reeling under severe power shortage in 2006 with no investment in system upgradation, inadequate metering, low collection and high losses. However between 2006 and 2011, the distribution franchisee in Bhiwandi managed to reduce the gap between average tariff and revenue realization and is expected to break even soon. Technical losses declined from 58 percent to 18.50 percent through network strengthening; 38,000 connections were regularized and 17,000 new connections provided; more than 80 percent of old meters were replaced by electronic meters; two new customer service centers were opened; and a 24*7 call center and mobile van were introduced for quick response to consumer complaints.
Maharashtra's experience with private participation in the power sector highlights the potential for improving distribution by enhancing accountability - as seen in companies investing in system strengthening, tightening their commercial practices, increasing efficiency and improving the quality of service,said Sheoli Pargal, Economic Advisor, World Bank and author of the report. At the same time, with the sectors reliance on commercial borrowings, lenders are well placed to incentivize performance since there could be ripple effects of shortfalls on lenders and, potentially, on the health of the financial sector. A history of state rescues seems to indicate that lenders do not adequately pressure distributors to improve their operational and financial performance, expecting to be paid back by the state, she added.
More Power to India also highlights some of the key deterrents holding back private entrants to the power sector. On the generation side, there are uncertainties related to domestic and imported coal; the poor financial health of the distribution companies; and difficulties with physical pooling of imported
 domestic coal among others. On the distribution side, some of the key deterrents include a high cost of power relative to tariffs; a regulatory process that faces political pressures in discharging its responsibilities to the sector; a lag in implementation of open access; lack of clarity on models (licenses vs. franchises); no pressure to improve commercial orientation; poor governance; and utilities not being service oriented.
While making an urgent call for change, the study recognizes the many impressive strides that the sector has made over the years. Generation capacity has tripled between 1991 and 2012, boosted by the substantial role played by the private sector. A state-of-the-art integrated transmission grid now serves the entire country. Private distribution utilities in Kolkata, Mumbai, Surat, and Ahmedabad, which have been owned and operated by the private sector since before Independence, point to potential gains from private participation. Grid-connected renewable capacity has risen from 18MW in 1990 to 25,856 MW in March 2013. And more than 28 million Indians have annually gained access to electricity between 2000 and 2010.
However, according to the study, the financial health of the sector is fragile, limiting its ability to invest in delivering better services. Total accumulated losses in the sector stood at Rs 2.88 trillion or 3% of GDP in 2013. Over the last two decades the sector has needed periodic rescues from the central government - a bailout of Rs 350 billion in 2001 and a of Rs 1.9 trillion that was announced in 2012.
Mounting Subsidies: High Opportunity Cost, Weak Targeting
Utilities face pressure to provide below-cost power to agricultural and rural residential consumers for which they are reimbursed through subsidy payments by state governments. Since 2003, in fact, subsidies booked have grown by 17 percent per year, and subsidies received by 12 percent per year; the cumulative gap between them was Rs 450 billion for 20033. This has had a crippling effect on the already struggling financials of the utilities, the study says.
As noted above, More Power to India recommends that the sector develop a commercial orientation - once there are clear signals of political will to run the sector in a commercial manner, with transparent subsidies going to only those who are eligible for such support, then day-to-day operations should be turned over to professional managers whose pay is linked to the performance of the utility, the study suggests.
Once the true subsidy requirement of eligible customers is made clear and transparent, and the rest of the sector is made to operate on commercially viable lines, the state Cross-subsidizing BPL customers and farmers is a very inefficient and non-transparent management approach, with many ineligible customers also receiving free power. The public has a right to be assured that subsidies are going to targeted groups; it also has a right to know how much these subsidies cost and that they are being administered responsibly,said Mohua Mukherjee, Senior Energy Specialist on India, World Bank.
State financial support, which has become essential to keep many utilities afloat, has a high opportunity cost. The study estimates that 15,000 hospitals and 123,000 schools could have been developed in 2011 if the power sector had not pre-empted these funds.
The study also highlights the need for better targeting of domestic subsidies. Lack of effective targeting of such subsidies has led to anomalies such as economically weaker sections of the population ending up paying more for consuming less power. In fact, in 2010 some 87 percent of the domestic electricity supplied India-wide was subsidized. Over half of subsidy payments (52 percent) India-wide went to the richest 40 percent of households in the country in 2010, the study adds.
Key recommendations:
- Utilities must be freed from government interference and their management professionalized. Despite corporatization, utility boards remain state-dominated, are filled with administrators, and are rarely evaluated on performance.
- Banks/lenders should hold utilities accountable for efficient operation and apply collective pressure to not lend to those that are not credit-worthy.
Regulators should go beyond the technical review of tariff petitions and focus on maintaining the health and integrity of the operations of the sector.
- Central government should pledge no future bailouts, give regulators autonomy and adequate resources, and hold them accountable for their performance. It should also allow competition to create pressure for efficient operation.
- State governments should pay subsidies transparently, fully, and on time, when they mandate free power supply. They should insist on evidence that the subsidies are going only to intended recipients.
- Improve operational efficiency by tracking the delivery of power from purchase to delivery; ensuring that revenues are collected; facilitating payment of bills through different channels; ensuring that customer service issues are addressed in a timely manner; undertaking operations and maintenance activities routinely, and ensuring financial sustainability.
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