



An analysis on how UDAY scheme will drive the coal power sector and in turn coal demand.

With the aim to make discoms financially and operationally healthy and to provide uninterrupted power for all with affordable rates the government came up with UDAY scheme or Ujwal Discom Assurance Yojna in 2015 to rescue the state power distribution companies which were facing huge debt. UDAY intends to ensure sustainable permanent solution to the problem. On the other hand, to reduce the problems related to discoms the government is also encouraging the states to join UDAY schemes.

If these problems are solved undoubtedly the financial health of the discoms would improve which also would ultimately lead to increase the power and coal demand in future. Since coal is majorly used for power generation it is essential to understand how the scheme will provide an opportunity to raise the coal sector. On this note, this article will give in-depth information on how UDAY scheme will drive coal power sector and in turn coal demand.

Indian power sector has undergone a huge transformation in the past 7-8 years be it generation and transmission capacity addition

COAL UDAY

or bringing renewable at the centre of power sector development or taking electricity to the remotest corner of the country. Private sector participation in the power sector has resulted into record capacity addition year after year. Government has announced a number of policy initiatives to boost the investment in the sector. Basic infrastructure has been laid to improve per capita electricity demand of the country which is currently mere one third of the world average. However, all these initiatives have not resulted into higher electricity demand which is showing almost a flat curve since last 3-4 years. The peak load deficit has drastically gone down from around 10 per cent to 2 per cent in these years.

A simple analysis will say that country's electricity generation has outpaced its electricity demand. But is that the real picture when majority of the 1.3 billion population of a country does not get sufficient electricity to meet their basic needs? The centre of this large crisis is our beleaguered discom sector which was suffering a loss of approximately ₹ 60,000 crore, says Rudranil Roysharma, GM & Senior Consultant – Energy Vertical, Feedback Business Consulting Services



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Pvt Ltd. In each financial year and have accumulated losses of approximately ₹ 3.8 lakh crore and outstanding debt of ₹ 4.30 lakh crore. The sector has already been bailed out once in the past however the lessons have not been learnt well. Roysharma outlines five key reasons why our electricity distribution sector went to this stage:

- High AT&C loss which the discoms are unable to pass on to the customers
- High Tariff Gap – Long pending tariff hike in the state where the domestic and agriculture customer mix is high
- Unrealistic tariff hike in the bulk consumer segment forcing them to opt for open access – industrial power tariff is 35 per cent more compared to industrial tariff globally
- Rising interest cost burden due to accumulated debt – Discoms have accumulated debt of ₹ 4,30,000 crore and losses of ₹ 3,60,000 crore
- Inefficient billing and collection – Billing and collection efficiency as low as 41 per cent in certain north eastern states.

He adds, "The electricity requirement reported by CEA is not the true requirement of the country but the amount of electricity that discoms can procure. Above factors have made discoms reeling under huge financial stress and as a result their electricity procurements have been stagnant in recent times." Every additional unit of costly electricity they buy, they go into higher financial loss. This has kept our country's electricity demand at an artificial low level and has impacted almost all the stakeholders in the value chain. Bank's NPAs have increased significantly. IPPs which were once the key growth engine of the sector were unable to sign PPAs for many of their capacities which have affected their ROI. More merchant plant has resulted into very low electricity price at the exchange which is also affecting the financials of the generation companies. Discoms were unable to pay dues of the generation companies which have hit their financials as well. Overall, this has transpired to a very negative and bleak picture for investment into the power sector. Hence, revival of the discoms was very much necessary to bring the sector back into the growth trajectory.

This is the genesis of Ujjwal Discom Assurance Yojana or more popularly known as 'UDAY'. The scheme was necessary for much needed revival of the discoms thereby helping other

stakeholders in the value chain. The scheme's focus on improving efficiency throughout the entire process on a sustained basis will ensure discoms become profitable in the future. Under the scheme, state government, which own the discoms, can take over 75 per cent of their debt as on September 30, 2015 and pay back lenders by selling bonds. For the remaining 25 per cent, discoms will issue bonds. The central government will ease rules to allow the states participating in the scheme to borrow more and help with the additional burden.

The rescue plan has the potential to provide a permanent resolution of past as well as potential future issues of the sector and empowers the utilities to break even in next 2-3 years. There are primarily four initiatives – improving operational efficiencies of discoms, reduction of cost of power, reduction in interest cost of discoms and enforcing financial discipline on discoms through alignment with state finances. Operational efficiency improvements are proposed to be brought in by compulsory smart metering, upgradation of transformers and metres to reduce electricity lost during transmission and distribution (or theft) from around 22 per cent to 15 per cent by 2018-19. "By the same year, the gap between average revenue realised (also known as tariff) and average cost of supply (or cost at which electricity is procured) will also be eliminated. Ministry of Power, Piyush Goyal mentioned that the scheme will eventually lead to a saving of ₹ 1.8 lakh crore annually," informs Roysharma.

While explaining how UDAY scheme will drive the coal power sector and in turn coal demand Roysharma says that this is a landmark reform for the electricity distribution sector and will enable discoms to buy more power in the future to unlock the true electricity demand of the country. Feedback Business Consulting Services feels there are two reasons why this will give boost to coal based power generation and in turn coal demand:

- Higher base load demand – With financial restructuring and reduction in AT&C loss, discoms will have better cost economics in place to buy more power to meet the growing electricity demand in their operating region. We feel this will lead to a massive growth in base load demand throughout the country. There are options available but coal based power is the most economical option to meet this higher base load demand which will give a boost to coal based power generation in the coming years.
- Focus on reduction of power procurement cost – We believe frequent tariff hike is not a realistic solution and hence states and discoms will try to restructure their energy mix to reduce the power procurement cost. This will minimise the gap between average revenue realised and average cost of power supply. Many states are already asking for wavering of their RPOs and will resort to more economical coal based power generation



Allocating coal linkage to a generating company, rather than to a specific plant gives companies the freedom to use the fuel in the most efficient way.



Sunil Misra,
Director General,
IEEMA

to keep their finance in check. This would definitely drive coal based power generation in the country.

"Coal sector reform has already been done. Domestic coal is now available in abundance hence our dependence on imported coal would likely to go down in future which will in turn reduce the power generation cost and will help each and every stakeholder in the value chain," Roysharma adds.

According to Anil Sardana, CEO and MD, Tata Power, the UDAY scheme is very hopeful and believes that it will empower the discoms and enhance its potential. He says, "UDAY is a very promising initiative. UDAY provides an enabling environment and assures the rise of vibrant and efficient state discoms through a permanent resolution of past as well as potential future issues of the sector. It empowers discoms with the opportunity to break even in the next few years."

A critical element of UDAY is that states will take over the future losses of discoms in graded manner. Thus starting from 2017-18, the loss that a discom may incur will be considered for the state's fiscal deficit FRBM targets. In 2017-18, 5 per cent of the previous year's losses would be taken over; in 2018-19, 10 per cent; 2019-20, 25 per cent; and by 2020-21, 50 per cent will have to be taken into the state's FRBM fiscal deficit targets. This essentially implies that unlike previous bailout schemes, this time the states will be responsible for any discom losses. This puts the onus on the state discoms and state government to ensure sustainable long term solutions.

"The UDAY scheme can be a torch bearer for the government's agenda 'Power for All by 2019' provided the states accept the scheme through a tripartite agreement between Power



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Ministry, government of India, state government and discoms as part of bailout plan and work towards reduction of AT&C losses and thereby making them financially viable. Once financial position of the discoms will improve with UDAY scheme, they will draw more power which in turn will lead to higher demand for coal," observes Sardana.

UDAY attempts to enforce fiscal discipline on states as it requires them to absorb a part of future losses of the discoms. It attempts to buffer the finances of the discoms, from the subsidies that state governments may want to provide for power. The states will now have to directly bear on their budgets the entire cost of the subsidies. Now state politicians will have to think twice before promising generous subsidies in the future since that will have to be financed within the 3 per cent state-level budget deficit on the long run. "It is the duty of state and discoms to invest in technology and collection to minimise the electricity pilferages," states Sunil Misra, Director General, IEEMA.

While speaking about how UDAY schemes will increase the coal demand Misra says, "UDAY ensures that the discoms reforms are not just distribution centric, but positively impact various inputs and outputs to the distribution function, even those which are not owned by the centre directly. It provides for easier transferring coal linkages from old to more modern plants, and incentives for creating large plants running at an economy of scale rather than operating small sub 200 MW plants. Allocating coal linkage to a generating company, rather than to a specific plant gives companies the freedom to use the fuel in the most efficient way."

Opportunity for Indian industry

Hope the UDAY scheme will improve and live up to the expectations of the industry but what sort of opportunities UDAY scheme will provide to the industry is important. On this note Misra states, "A turnaround of distribution segment is critical to make the power sector commercially viable and to deliver reliable power supply at reasonable cost. UDAY will bring an increased focus on bringing in financial, operational and technical/collection efficiency. These measures corroborated with better coal linkages, energy efficiency initiatives and demand side management will prove to be elixir to the nation which loses one third of their legal revenue through AT&C losses and the ultimate victim is the honest consumer that pays their bills on time."

However, sustained long term efforts will be required on the part of all stakeholders like the central government, state government, ministries, commercial banks, utilities, government regulators, and end users to lead to permanent changes lending huge credibility to the 24 / 7 power promised by the government by 2019. ⚡