UNIT-3

Project formulation: Project formulation is defined as ***taking a first look carefully and critically at a project idea by an entrepreneur to build up an all round beneficial to project after carefully weighing its various components.*** It is formulated by the entrepreneur with the assistance of specialists or consultants. Project formulation is, therefore, a process whereby the entrepreneur makes an objective and independent assessment of the various aspects of an investment proposition of project idea for determining its total impact and also its liability. By all means, this strategy forms an important stage in the pre investment phase-that is the period from the conception of an idea until the final analysis to decide about the future of a project idea. This makes it an analytical management aid. The aim of project formulation is to achieve the project objectives with the minimum expenditure and adequate resources. In other worlds, it is to derive maximum benefits from minimum expenses in a short span of time..

It is assessment of the feasibility of a proposal or a scheme of a borrower based on the examination of factors like the capacity of the unit or farm to produce the repaying capacity generated by the funds asked for , the assets and liabilities and so on. These factors are technical , economic, managerial, financial, commercial, organizational and legal.

The project size is determined by taking into consideration factors like the area of operation, the types of and levels and activities undertaken, the type and size of the organization, amount of investment necessary and the time required for the completion of the activities contemplated under the projects

Phases in project formulation:

1. Conception of an idea
2. Analysis of related aspects
3. Formulation of a project
4. Design of project

Sequential stages of project formulation:

1. **Feasibility analysis**: this is the very first stage in project formulation. At this stage, the project idea is examined from the point of view of whether to go in for a detailed investment proposal or not. As project idea is examined in the context of internal and external constraints. Three alternatives could be considered. **First** the project idea seems to be feasible**; second** the project idea is not a feasible one and third, unable to arrive at a conclusion for want of adequate data. If it is feasible., we proceed to the second step, if not feasible, we abandon the idea and if sufficient data are not available, we make more efforts to collect the required dta and design development

2. **Techno Economic analysis**: In this step estimation of project demand potential and choice of optimal technology is made As the project may produce goods or services., it is imperative to know the market for such goods or services produced. Market analysis is also in build in this step. The choice of technology itself will be based on the demand potential and aid in

project design. Techno economic analysis gives the project a unique individuality and sets the stage for derailed design development.

3. **Project design and Network Analysis**: This important defines individual activities which constitute the project and their inter- relationship with each other. The sequence of events of the project is presented. A detailed work plan of the project is prepared with time allocation for each activity and presented in a network drawing. Project design is the heart of the project entity. This paves the way for detailed identification and qualification of the project inputs an essential step in the development of the financial and cost benefit profile of project .

4. **Input Analysis**. This step assesses the input requirements during the construction of the project and also during the operation of the project. In the earlier step, a project was divided int several activities. Now, it is better t see to the inputs required for each activity and sum it up to get at the total input requirements on qualitative and quantitative terms. Inputs include materials, human resources. Input analysis also considers the recurring as well as non recurring resource requirements of the project and evaluate the feasibility of the project from the point of view of the availability of these resources. This will aid in assessing the project cost itself which in turn is necessary for financial analysis or cost benefit analysis.

5. **Financial analysis**: This stage mainly involves estimating the project costs, estimating its operating costs and fund requirements. Financial analysis also helps in comparing various project proposals on a common scale, thereby aiding the decision maker. Some of the analytical tools used in financial analysis ar discounted cash flow, cost volume-profit relationship and ratio analysis, It is very essential to take caution in preparing financial estimates. The objective of this strategy caution is to develop the project taking into consideration resources and also to identify these characteristics. Investment decisions whether made for the provision of goods or services involve commitment of resources in future. Since investment proposition has a very long time horizon, it is absolutely necessary to exercise due car and foresight in developing project financial forecasts.

6. **Social Cost Benefit analysis** : The overall worth of a project is the main consideration here. Cost benefit analysts will consider the project fro national viability point of view. Here again , the project design forms the basis of evaluation. When we talk of cost benefit analysis, we not only take into account the apparent direct costs an direct benefits of the project but also the costs which all entities connected with the project have to bear and the benefits which will be enjoyed by all such entities. This strategy is now taken to be the internally recognized system of project formulation.

7. **Pre-investment analysis**: The project proposal gets a forma and final shape at this stage. All the results obtained in the above steps are consolidated and various conclusions arrived at to present a clear picture. At this stage, the project is presented n such a way that the project-sponsoring body, the project implementing body and the external consulting agencies are also to decide whether to accept the proposal or not. The sum total of the pre investment appraisal

is to present the project idea in a form in which the project-sponsoring body the project-implementing body can take an investment decision regarding the project.

Project Constraints:

Project formulation is accompanied with internal and external constraints.

Internal constraints arise on account of the limitations of the management system which will eventually be responsible for the implementation of a project. Inputs resources and outputs are the three major elements of the structural aspects of an existing management system,

External constraints depend upon the environment which imposes limitations on the size, nature, location and the extent t of the project,

Some of the methods of project appraisal are as follows:

1. Economic Analysis:

Under economic analysis, the project aspects highlighted include requirements for raw material, level of capacity utilization, anticipated sales, anticipated expenses and the probable profits. It is said that a business should have always a volume of profit clearly in view which will govern other economic variables like sales, purchases, expenses and alike.

It will have to be calculated how much sales would be necessary to earn the targeted profit. Undoubtedly, demand for the product will be estimated for anticipating sales volume. Therefore, demand for the product needs to be carefully spelled out as it is, to a great extent, deciding factor of feasibility of the project concern.

In addition to above, the location of the enterprise decided after considering a gamut of points also needs to be mentioned in the project. The Government policies in this regard should be taken into consideration. The Government offers specific incentives and concessions for setting up industries in notified backward areas. Therefore, it has to be ascertained whether the proposed enterprise comes under this category or not and whether the Government has already decided any specific location for this kind of enterprise.

2. Financial Analysis:

Finance is one of the most important pre-requisites to establish an enterprise. It is finance only that facilitates an entrepreneur to bring together the labour of one, machine of another and raw material of yet another to combine them to produce goods.

In order to adjudge the financial viability of the project, the following aspects need to be carefully analysed:

1. Assessment of the financial requirements both – fixed capital and working capital need to be properly made. You might be knowing that fixed capital normally called 'fixed assets' are those tangible and material facilities which purchased once are used again and again. Land and buildings, plants and machinery, and equipment's are the familiar examples of fixed assets/fixed capital. The requirement for fixed assets/capital will vary from enterprise to enterprise depending upon the type of operation, scale of operation and time when the investment is made. But, while assessing the fixed capital requirements, all items relating to the asset like the cost of the asset, architect and engineer's fees, electrification and installation charges (which normally come to 10 per cent of the value of machinery), depreciation, pre-operation expenses of trial runs, etc., should be duly taken into consideration. Similarly, if any expense is to be incurred in remodeling, repair and additions of buildings should also be highlighted in the project report.

2. In accounting, working capital means excess of current assets over current liabilities. Generally, 2: 1 is considered as the optimum current ratio. Current assets refer to those assets which can be converted into cash within a period of one week. Current liabilities refer to those obligations which can be payable within a period of one week. In short, working capital is that amount of funds which is needed in day today's business operations. In other words, it is like circulating money changing from cash to inventories and from inventories to receivables and again converted into cash. This circle goes on and on. Thus, working capital serves as a lubricant for any enterprise, be it large or small. Therefore, the requirements of working capital should be clearly provided for. Inadequacy of working capital may not only adversely affect the operation of the enterprise but also bring the enterprise to a grinding halt.

The activity level of an enterprise expressed as capacity utilization, needs to be well spelt out in the business plan or project report. However, the enterprise sometimes fails to achieve the targeted level of capacity due to various business vicissitudes like unforeseen shortage of raw material,

unexpected disruption in power supply, inability to penetrate the market mechanism, etc. Then, a question arises to what extent and enterprise should continue its production to meet all its obligations/liabilities. 'Break-even analysis' (BEP) gives an answer to it. In brief, break-even analysis indicates the level of production at which there is neither profit nor loss in the enterprise. This level of production is, accordingly, called 'break-even level'.

3. Market Analysis:

Before the production actually starts, the entrepreneur needs to anticipate the possible market for the product. He/she has to anticipate who will be the possible customers for his product and where and when his product will be sold. There is a trite saying in this regard: "***The manufacturer of an iron nails must know who will buy his iron nails."***

This is because production has no value for the producer unless it is sold. It is said that if the proof of pudding lies in eating, the proof of all production lies in marketing/ consumptio. In fact, the potential of the market constitutes the determinant of probable rewards from entrepreneurial career.

Thus, knowing the anticipated market for the product to be produced becomes an important element in every business plan. The various methods used to anticipate the potential market, what is named in 'Managerial Economics' as 'demand forecasting', range from the naive to sophisticated ones.

The commonly used methods to estimate the demand for a product are as follows:

1. Opinion Polling Method:

n this method, the opinions of the ultimate users, i.e. customers of the product are estimated. This may be attempted with the help of either a complete survey of all customers (called, complete enumeration) or by selecting a few consuming units out of the relevant population (called, sample survey).

Let us discuss these in some details:

(a) Complete Enumeration Survey:

In this survey, all the probable customers of the product are approached and their probable demands for the product are estimated and then summed. Estimating sales under this method is very simple. It is obtained by simply adding the probable demands of all customers. An example should make it clear.

Suppose, there are total N customers of X product and everybody will demand for D numbers of it. Then, the total anticipated demand will be:

$\mathbf{N \sum i=1\ D_i N}$

Though the principle merit of this method is that it obtains the first-hand and unbiased information, yet it is beset with some disadvantages also. For example, to approach a large number of customers scattered all over market becomes tedious, costly and cumbersome. Added to this, the consumers themselves may not divulge their purchase plans due to the reasons like their personal as well commercial/business privacies.

(b) Sample Survey:

Under this method, only some number of consumers out of their total population is approached and data on their probable demands for the product during the forecast period are collected and summed. The total demand of sample customers is finally blown up to generate the total demand for the product. Let this also be explained with an example.

Imagine, there are 1000 customers of a product spread over the Faridabad market. Out of these, 50 are selected for survey using stratified method. Now, if the estimated demand of these sample customers is D_i, i.e., it refers to 1 2 3….50, the total demand for the entire group of customers will be

$$\mathbf{50 \sum n_i D_i = n_1 D_1 + n_2 D_2 + n_3 D_3 \ldots\ldots\ldots n_{50} D_{50}}$$

Where n, is the number of customers in group i, and $n_1 + n_2 + n_3 \ldots n_{50} = 1000$.

But, if all the 1000 customers of the group are alike, then the selection may be done on a random basis and total demand for the group will be:

$\mathbf{(D_1 D_2 + D_3 + D_4 \ldots D_5)\ 1000\ /50}$

No doubt, survey method is less costly and tedious than the complete enumeration method.

(c) Sales Experience Method:

Under this method, a sample market is surveyed before the new product is offered for sale. The results of the market surveyed are then projected to the universe in order to anticipate the total demand for the product.

In principle, the survey market should be the true representative of the national market which is not always true. Suppose, if Delhi is selected as a sample market, it may not be a true representative of a small place, say Silchar in Assam simply because the characteristic features of Delhi are altogether different from those of a small town like Silchar.

Again, if we select Agra as a sample market, sales in Agra would be influenced by the size of the floating tourist's population throughout the year. But this feature is not experienced by many other places again like Silchar in Assam.

(d) Vicarious Method:

Under the vicarious method, the consumers of the product are not approached directly but indirectly through some dealers who have a feel of their customers. The dealers' opinions about the customers' opinion are elicited. Being based on dealers' opinions, the method is bound to suffer from the bias on the part of the dealers. Then, the results derived are likely to be unrealistic. However, these hang-ups are not avoidable also.

2. Life Cycle Segmentation Analysis:

It is well established that like a man, every product has its own life span. In practice, a product sells slowly in the beginning. Backed by sales promotion strategies over period, its sales pick up. In the due course of time, the peak sale is reached. After that point, the sales begin to decline. After, some time, the product loses its demand and dies. This is natural death of a product. Thus, every product passes through its 'life cycle'. This is precisely the reason why firms go for new products one after another to keep themselves alive.

Based on above, the product life cycle has been divided into the following five stages:

1. Introduction

2. Growth

3. Maturity

4. Saturation

5. Decline

The sales of the product vary from stage to stage and follows S-shaped curve as shown in Figure 16.1:

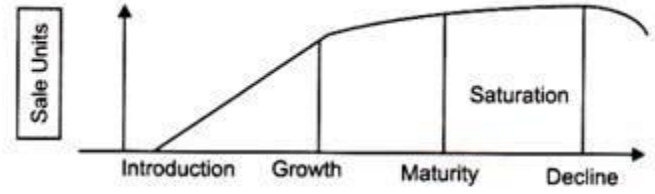

Fig. 16.1 Product Life-Cycle

Considering the above five stages of a product life cycle, the sales at different stages can be anticipated.

4. Technical Feasibility:

While making project appraisal, the technical feasibility of the project also needs to be taken into consideration. In the simplest sense, technical feasibility implies to mean the adequacy of the

proposed plant and equipment to produce the product within the prescribed norms. As regards know-how, it denotes the availability or otherwise of a fund of knowledge to run the proposed plants and machinery.

It should be ensured whether that know-how is available with the entrepreneur or is to be procured from elsewhere. In the latter case, arrangement made to procure it should be clearly checked up. If project requires any collaboration, then, the terms and conditions of the collaboration should also be spelt out comprehensively and carefully.

In case of foreign technical collaboration, one needs to be aware of the legal provisions in force from time to time specifying the list of products for which only such collaboration is allowed under specific terms and conditions. The entrepreneur, therefore, contemplating for foreign collaboration should check these legal provisions with reference to their projects.

While assessing the technical feasibility of the project, the following inputs covered in the project should also be taken into consideration:

(i) Availability of land and site.
(ii) Availability of other inputs like water, power, transport, communication facilities.
(iii) Availability of servicing facilities like machine shops, electric repair shop, etc.
(iv) Coping-with anti-pollution law.
(v) Availability of work force as per required skill and arrangements proposed for training-in-plant and outside.
(vi) Availability of required raw material as per quantity and quality.

5. Management Competence:

Management ability or competence plays an important role in making an enterprise a success or otherwise. Strictly speaking, in the absence of managerial competence, the projects which are otherwise feasible may fail.

On the contrary, even a poor project may become a successful one with good managerial ability. Hence, while doing project appraisal, the managerial competence or talent of the promoter should be taken into consideration.

Planning Commission's guidelines for project Formulation/ Feasibility reports for Industrial projects

In order to process investment proposals and arrive at investment decisions, the Planning Commission of India has also issued some guidelines for preparing/ formulating realistic business plans/industrial projects. So far as feasibility report is concerned, it lies in between the project formulating stage and the appraisal and sanction stage. The project formulation stage involves the identification of investment options by the enterprise and in consultation with the Administrative Ministry, the Planning Commission and other concerned authorities.

1. General Information:

The feasibility report should include an analysis of the industry to which the project belongs. It should deal with the past performance of the industry. The description of the type of industry should also be given, i.e., the priority of the industry, increase in production, role of the public sector, allocation of investment of funds, choice of technique, etc. This should also contain information about the enterprise submitting the feasibility report.

2. Preliminary Analysis of Alternatives:

This should contain present data on the gap between demand and supply for the outputs which are to be produced, data on the capacity that would be available from the projects that are in production or under implementation at the time the report is prepared, a complete list of all existing plants in the industry, giving their capacity and level of production actually attained, a list of all projects for which letters of intents/ licenses have been issued and a list of proposed projects.

All options that are technically feasible should be considered at this preliminary stage. The location of the project as well as its implications should also be looked into. An account of the foreign exchange requirement should also be taken. The profitability of different options should also be given. The rate of return on investment should be calculated and presented in the report. Alternative cost calculations vis-a-vis return should be presented.

3. Project Description:

The feasibility should provide a brief description of the technology /process chosen for the project. Information relevant to determining optimality of the location chosen should also be included. To assist in the assessment of the environmental effects of a project, every feasibility report must present the information on specific points, i.e., population, water, air, land, flora and fauna; effects arising out of project's pollution, other environmental discretions, etc.

The report should contain a list of the operational requirements of the plant, requirements of water and power, requirements of personnel, organisational structure envisaged, transport costs, and activity-wise phasing of construction and factors affecting it.

4. Marketing Plan:

A good marketing plan should contain the following items:

a. Data on the marketing plan.

b. Demand and prospective supply in each of the areas to be served.

c. The method and data used for main estimates of domestic supply and selection of the market areas should be presented. Estimates of the degree of price sensitivity should be presented.

d. It should contain an analysis of past trends in prices.

5. Capital Requirements and Costs:

The estimates should be reasonably complete and properly estimated. Information on all items of costs should be carefully collected and presented.

6. Operating Requirements and Costs:

Operating costs are essentially those costs which are incurred after the commencement of commercial production. Information about all items of operating cost should be collected. Operating costs relate to the cost of raw materials and intermediates, fuel, utilities, labour, repair and maintenance, selling expenses, and other expenses.

7. Financial Analysis:

The purpose of this analysis is to present some measures to assess the financial viability of the project. A proforma Balance Sheet for the project data should be presented. Depreciation should be allowed for on the basis of specified rate by the Bureau of Public Enterprises (BPE). Foreign exchange requirements should be cleared by the Department of Economic Affairs (DEA). The feasibility report should take into account income-tax rebates for priority industries, incentives for backward areas, accelerated depreciation, etc. The sensitivity analysis should also be presented. The report must analyse the sensitivity of the rate of return of change in the level and pattern of product prices.

8. Economic Analysis:

Social profitability analysis needs some adjustment in the data relating to the costs and returns to the enterprise. One important type of investment involves a correction in input and costs, to reflect the true value of foreign exchange, labour and capital. The enterprise should try to assess the impact of its operations on foreign trade. Indirect costs and benefits should also be included in the report. If they cannot be quantified, they should be analysed and their importance emphasised.

9. Miscellaneous Aspects:

The preceding three areas are deemed appropriate to almost every new small enterprise. Notwithstanding, depending upon the size of the operation and peculiarities of a particular project, other items may be considered important to be applied out in the project report. To mention a few, probable use of minicomputers or other electronic data processing services, cash flow statements, method of accounting etc., may be of great use in some micro and small enterprises.

CONCLUSION: Project formulation is a key input of management aid. The process of roject formulation involves a detailed study of the environing, weighting objectively the internal and external constrains and development of the project idea, stage by stage, into an investment proposition. The conclusion dawn at the end of each stage form the basis of development of the next stage. At each stage, the entrepreneur or intrapreneur or a team of consultants have to look not only forward but also backward. The forward look is necessary to take the project formulation forward and the backward look is to recheck and if necessary strengthen or modify the project on the basis of experience gained in the project formulation. Thus, project formulation is a significant link between project identification and project appraisal by financial institutions.

Thus, We find right from the time of conceiving he the profitable opportunity to converting the idea from the mind to the marketable product, many complications are involved. Therefore, an entrepreneur has to carefully study the various determinants which will ultimately result in the success or failure of the establishment of an industrial unit. During this period of time, the entrepreneur is expected to weigh each factor carefully and take decisions on the basis of the merits and the advantages of each factor so that the profitable opportunity conceived can be transformed into a reality with a appreciable degree of success.

Project Financing in India

Project Finance is one of the key focus areas in today's world because of continuous growth and expansion of the industries at a rapid rate. Project finance is a centuries-old form of financing high-risk, development-oriented projects.

Project finance is the long-term financing of infrastructure and industrial projects based upon non-recourse or limited alternative of financial structure where project debt and equity used to finance the project are paid back from the cash flow engendered by the project.

They are most ordinarily non-recourse loans, which are fortified by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors, a decision in part braced by financial modeling.

Methods of Project Financing

A survey said that 90% of respondents identified money as the greatest obstacle to implementation of any project.

The various sources of finance can be broadly divided into two categories, viz. equity capital and debt capital (borrowed capital). The combination of equity and debt should be judiciously chosen, and it will vary according to the nature of the project. The project manager can choose any one or a combination of two or more of these methods to finance the project.

1. Share capital – equity capital and preference capital.
2. Term loan
3. Debenture capital
4. Commercial banks
5. Bills discounting

Some more types of financing available are:

Seed Capital

In consonance with the Government policy which boosts a new class of entrepreneurs and also aims wider spreading of ownership and control of manufacturing units, a distinct scheme to complement the resource of an entrepreneur has been presented by the Government. Assistance in this scheme is accessible in the nature of seed capital which is generally given by way of long term interest free loan. Seed capital aid is provided to small as well as medium scale units promoted by eligible entrepreneurs.

Government Subsidies

Subsidies drawn-out by the Central as well as State Government form a very significant type of funds presented to a company for implementing its project. Subsidies may be available in the nature of absolute cash grant or long-term interest free loan. In fact, while settling the means of finance, Government subsidy forms an key source having a vital bearing on the putting into practice of many a projects.

Stages in Project Financing:

I. Pre- Finance stage: *It includes the following*

a)Project identification

A Project or Projects selected should be integrated with the Strategic Plan of the Organisation. The project plan should match the goals of the organization. It should be realistic to be implemented.

b) Identifying risk and minimizing the risk

Risk management is one of the key steps that should be focused on before the project financing venture begins. Before investing, the lender has every right to check if the project has enough available resources to avoid any future risks.

"The right project at the right time at the right place and at the right price". There should be adequate amount of resources available for the project to be implemented.

c) Technical and Financial feasibility

An organization before starting any new project or expanding an existing one must look into analyzing each and every factor which is essential for the project to be feasible. It must be financially as well as technically feasible.

II. Financing Stage

a) Arrangement of finances (equity/debt/loan): In order to take care of the finances related to the project, the sponsor needs to acquire equity or loan from a financial services organisation whose goals are aligned to that of the project

b) Loan or Equity Negotiation and Syndication of the same: During this step, the borrower and lender negotiate the loan amount and come to a unanimous decision regarding the same.

c) Documentation and checking all the rules and regulations or policies relating to the starting of the Project: In this step, the terms of the loan are mutually decided and documented keeping the policies of the project in mind.

d) Payment: Once the loan documentation is done, the borrower receives the funds as agreed previously to carry out the operations of the project.

III. Post Financing:

a) Monitoring and review of project from time to time. The project manager must keep a check on the proper working of the project.

b) Project Closure – It is ending the project

c) Repayment and Monitoring: The amount taken in the form of loan, equity and debt must be repaid back and proper monitoring and control of the project must be carried.

Framework and Guidelines

The list of major contracts for project consist of

Concession agreement, license or mineral lease, construction contract or a development management agreement, supply agreement, sales agreement, operating agreement, other major contracts may occur in any specific project depending on the structure accepted.

The borrower may have to get certain statutory and non – statutory clearances essential for the projects like techno economic clearance, pollution, environment and forest clearance, company registrations, financing and land availability/ concessions etc.

The promoter while making the application to the financial institutions records the copies of documents most vital of which are: i) copy of letter of allotment of plot/ sale deed in good turn of the borrower of the plot. ii) Detailed plan of project approved by the local body. iii) Partnership deeds/ articles of association in case of a company.

Key Features of Project Financing

Since a project deals with huge amount funds, it is important that you learn about this structured financial scheme. Below mentioned are the key features of Project Financing:

Capital Intensive Financing Scheme: Project Financing is ideal for ventures requiring huge amount of equity and debt, and is usually implemented in developing countries as it leads to economic growth of the country. Being more expensive than corporate loans, this financing scheme drives costs higher while reducing liquidity. Additionally, the projects under this plan commonly carry Emerging Market Risk and Political Risk. To insure the project against these risks, the project also has to pay expensive premiums.

Risk Allocation: Under this financial plan, some of the risks associated with the project is shifted towards the lender. Therefore, sponsors prefer to avail this financing scheme since it helps them mitigate some of the risk. On the other hand, lenders can receive better credit margin with Project Financing.

Multiple Participants Applicable: As Project Financing often concerns a large-scale project, it is possible to allocate numerous parties in the project to take care of its various aspects. This helps in the seamless operation of the entire process.

Asset Ownership is Decided at the Completion of Project: The Special Purpose Vehicle is responsible to overview the proceedings of the project while monitoring the assets related to the project. Once the project is completed, the project ownership goes to the concerned entity as determined by the terms of the loan.

Zero or Limited Recourse Financing Solution: Since the borrower does not have ownership of the project until its completion, the lenders do not have to waste time or resources evaluating the assets and credibility of the borrower. Instead, the lender can focus on the feasibility of the project. The financial services company can opt for limited recourse from the sponsors if it deduces that the project might not be able to generate enough cash flow to repay the loan after completion.

Loan Repayment With Project Cash Flow: According to the terms of the loan in Project Financing, the excess cash flow received by the project should be used to pay off the outstanding

debt received by the borrower. As the debt is gradually paid off, this will reduce the risk exposure of financial services company.

Better Tax Treatment: If Project Financing is implemented, the project and/or the sponsors can receive the benefit of better tax treatment. Therefore, this structured financing solution is preferred by sponsors to receive funds for long-term projects.

Sponsor Credit Has No Impact on Project: While this long-term financing plan maximises the leverage of a project, it also ensures that the credit standings of the sponsor has no negative impact on the project. Due to this reason, the credit risk of the project is often better than the credit standings of the sponsor.

Types of Sponsors in Project Financing

In order to determine the objective of the project and the risks related to it, it is important to know the type of sponsor associated with the project. Broadly categorised, there are four types of project sponsors involved in a Project Financing venture:

Industrial sponsor - These type of sponsors are usually aligned to an upstream or downstream business in some way.
Public sponsor - The main motive of these sponsors is public service and are usually associated with the government or a municipal corporation.
Contractual sponsor - The sponsors who are a key player in the development and running of plants are Contractual sponsors.
Financial sponsor - These type of sponsors often partake in project finance initiatives and invest in deals with a sizeable amount of return.

Conclusion

Project Financing is a long-term, non-recourse or limited recourse financing scheme that is used to fund massive projects which can be repaid using the project cash flow obtained after the completion of the project. This scheme offers financial aid off balance sheet, therefore, the credit of the shareholder and Government contracting authority does not get affected. In Project Financing, multiple participants are allowed to handle the project while the ownership of the project is entitled according to the terms of the loan only after the project is completed. This financial scheme offers better credit margin to lenders while shifting some of the risk from the sponsors to the lenders.

As the Indian Government continues to investment on the infrastructure of the country, it is expected that there will be massive developments in future in terms of power, transportation, bridges, dams etc. Most of these projects will be using the Public Private Partnership (PPP) method indicating a rise in Project Financing during the upcoming years. This entire cycle will further help improve the economic condition of India.