EmPower Nigeria

Improving Nigeria's electricity supply industry through public education

MacArthur Foundation Supported by John D. and Catherine T. MacArthur Foundation

A Weekly Publication of Nextier Power Advisory. Investment. Services

Vol. 1 Issue 11
Sept. 20, 2017

Nextier Power is a consulting firm that provides policy advisory, investment advisory, and support services to the electricity supply industry. The firm aims to use this weekly publication to educate Nigerians on the intricacies of the Nigeria electricity supply industry on the assumption that a more informed public would advocate for the right policies and programmes which, in turn, would lead to a robust market that delivers the electricity needs of Nigerians. This column will cover everything from the basics of the industry to the more intricate, sometimes, complex policies and programmes.

Power Sector Liquidity Crisis

Introduction

The vision of the electricity sector reform was to create an efficient market structure, within a clear regulatory framework, that encourages competitive markets for electricity trading. This vision is guided by the Electricity Power Sector Reform Act (EPSRA) 2005 that provides for a phased implementation of the reforms aimed at achieving a full competitive market. However, the Nigerian Electricity Supply Industry (NESI) has encountered a liquidity crisis in its bid to achieve this vision. The **liquidity crisis** refers to a situation where revenues that should be received for electricity supplied do not flow back through the value chain. In a typical flow, Nigerian Bulk Electricity Trading Plc. (NBET) purchases power from the generating companies (GenCos) and sells it to the distribution companies (DisCos) who then sell the power to the end consumers. However, due to inefficiencies in collection of receipts, DisCos are not able to pay for the energy allocated to them. This, in turn, hinders NBET from paying their bills to GenCos, and the latter are unable to pay for the fuel needed to generate electricity. As a result, this liquidity challenge threatens the viability of the entire NESI.

The Beginning

The long-term goal of the reform process is to achieve a competitive electricity market that is to be implemented through a process phased into four market stages: Pre-Transition, Transition, Medium Term and Competitive Electricity Markets. The reform process is currently in the Transitional Electricity Market (TEM).

TEM was designed to be a contract-driven market where there is cost reflective tariff and market participants consistently honour their obligations. TEM should have commenced upon the handover of the privatised electricity companies (01 November 2013), however, due to a number of unmet conditions, government declared an Interim Period (IP) during which a non-cost reflective tariff (MYTO 2) was implemented. As expected, the IP resulted in revenue shortfalls that the Federal Government of Nigeria (FGN) pledged to cover.

At the end of the IP (31 January 2015) and commencement of TEM (01 February 2015), NESI had accumulated a shortfall of about N213 Billion which the FGN made available to the sector through the Central Bank of Nigeria (CBN) subject to certain the loan conditions. The loan repayment mechanism was to be inputted to the revised tariff (MYTO. 2.1). However, there are still disagreements that MYTO 2.1 is still non-cost reflective.

The current tariff, MYTO 2015, came into effect in January 2016 with an increase almost double the previous tariff for most Distribution companies. By December 2016, the industry is believed to have accumulated an estimated N1 trillion in shortfall. Some of the several contributory factors are analysed in the rest of this article.

Contributing Factors

Market Indiscipline

The reform process envisaged that NESI privatisation would attract private sector discipline to the sector. This is yet to be realised. Despite tariff increases, DisCos recorded an average of 30% payment to NBET for the energy they received in 2016. A much higher performance was achieved under government ownership. The private owners are yet to achieve the agreed reduction in ATC&C (Technical, Commercial and Collection) losses. Metering of customers is moving at snail speed. Investment in distribution infrastructure is still low. Furthermore, DisCos have been accused of inaccurate reporting of their customer numbers and actual revenues collected. An increased customer base should equate to a lower tariff but it is more profitable for DisCos to report a lower customer base.

Non-Cost Reflective Tariff

Tariff calculations are based on customer numbers, generation capacity, cost of capital, inflation, foreign exchange (FX) rate, etc. A cost reflective tariff ensures that DisCos can cover their operational expenses, bills from other companies in the value chain, achieve a decent rate of return, and account for fluctuations in inflation and FX. The current electricity tariff cannot cover the above costs. This situation is unsustainable and would lead to increasing financial shortfall in NESI. There has been a reluctance to implement a cost-reflective tariff because there is a fear that the masses would resist such an increase. There is also an argument that power supply should be improved first before tariffs can be increased.

Weak Regulatory Institutions

The effective regulation of NESI is essential to ensure that market participants adhere to market rules. At privatization, 60% of each of the DisCos was sold to the private sector while 40% remained under government ownership. The Bureau of Public Enterprises (BPE) sits on the Board of the DisCos to monitor their activities, ensure that performance agreements are respected, and the interests of the government and people are protected. However, today, performance targets are not met; performance monitoring is poor, and government is yet to make profit from its stake in these companies.

Likewise, there have been inconsistencies in NERC regulations and these are not being addressed because the position of Chairman has been vacant since the December 2015. Therefore, there is weak enforcement of rules, regulations and codes leaving industry participant to act in their best interest and probably at the disadvantage of the industry.

Energy Theft and Non-Payment of Bills

Electricity consumers play a major role in the liquidity problem. Electricity is not a social good, and should not be consumed without payment. A major challenge is the failure of the government and its agencies (including the Military) to pay their bills. This bill is currently in the hundreds of millions of Naira. DisCos collect less than 50% of the revenue due from the electricity supplied to end user due to both commercial and collection losses.

Economic Factors

The macroeconomic instability in Nigeria has dire implications for NESI. CBN official foreign currency exchange rate moved from N197 to N305 for US$1 in only a few months. Most of the capital expenditure in NESI is denominated in United States dollars while payment for electricity consumed is in Naira. With the significant devaluation of the Naira, most of the power companies have mounting foreign currency loans and also insufficient access to foreign currency.

The Implications

The liquidity crisis implies that TEM hasn't achieved its contract-based objectives such as enforceable contracts, full cost recovery by investors, and certainty of revenues. Investor confidence for financing and investing in NESI has significantly eroded and the risk profile of the sector has significantly increased. Without a cost reflective tariff, growth of NESI will remain stunted and there is not likely to be much improvement in power delivery to electricity consumers. However, FGN seems to be caught in a Catch-22 where the consumers want to see improvements in supply before they accept and increase in tariff.

Efforts to Curtail the Crisis

*Metering***:** Some of the ongoing policy interventions include a directive to NERC and the DisCos to accelerate rollout of meters across all customer classes.

Strengthen the Institutions: The FGN should consider and implement policies that would strengthen transparency, discipline, and corporate governance for all market participants in accordance with their contractual commitments.

Honour thy Bills: The FGN has begun verifying debts it owes to the sector and has given its commitment to pay. Other customers should do likewise.

Eligible Customers: The FGN approved a policy directive that allows maximum demand customers to buy electricity directly from a GenCo cutting out the DisCos. It is hoped that this should increase liquidity in the market..

Recommendations

Institutions: The FGN should move to strengthen the institutions in the sector. The Chairman of NERC should be confirmed as a matter of urgency. NEMSA needs to be strengthened to execute its functions of enforcing technical standards and regulations, technical inspection, testing and certification. The Independent System Operator and Transmission Service Provider should be autonomous in their operations, preferably each with an independent operating license. NBET should be strengthened to access the security cover to pay off the GenCos when the need arises.

Remittance Targets: The government should set targeted increases for DisCo remittances. These targets should be strictly enforced and failure to meet the progressive targets should incur a fine.

Conclusion

The liquidity crisis in NESI is simply a symptom of the challenges in the sector and the broader economy. While the FGN is taking assertive steps to establish a sustainable market, it is imperative that the liquidity crisis be carefully managed through close monitoring of the market to identify and correct the weak links in the value chain.

Author:
Oby Eze-Okoli an Energy Economist and an Erasmus Mundus Fellow.

Editor:
Chinazo Ifeanyi-Nwaoha is a power sector analyst focused on the interplay of policy-practice and regulation.

Next Topics	
Sept 27	PSRP to the rescue
Oct 4	Power: a social service or a business venture
Oct 11	Solar 101

www.nextierpower.com empower@nextierpower.com