

- Economic use should be made of various types of insurance.

VI. Financing of Projects

Project financing is immensely difficult to arrange for and particularly so for projects of a limited recourse nature. This situation stems from the increasing reluctance of governments to guarantee political, exchange rate and other risks. Many governments are simply not in a position to add to their liabilities or contingent liabilities. Consequently the financial solution, or part of the financial solution, must come from the private sector. And the solution can appear to be quite daunting: investors and suppliers of debt are often faced with the prospect of investing or lending in a project in return for the cash flow of the project, which may be for twenty or more years.

Should the project collapse or be threatened by collapse the prime security for the investors or lenders rests in the legal documents of the project, which may be of little, if any, comfort. Few companies and financiers are willing to accept these risks. Fewer are willing to accept this risk in developing nations where many of these projects are contemplated.

If the non-financial players in the capital project market can bring in equity to the project a major hurdle is cleared. However, if financial strength is not an option or cannot be mustered, then an alternative is to be in a position to identify the financial players who can bring financial muscle to a project and to understand how to manage these sources of capital. This outside financial muscle often comes with high costs - either in up front fees, or through equity sharing (and the related control implications).

These realities of the international capital project market highlight the need for players in the market to develop realistic options for their participation. Developing and arranging appropriate financing structures and risk management mechanisms is a central issue in international capital projects and involves the application of financial engineering.

Risk Management and Innovative Financing

Risks in capital projects relate to financial risks (such as currency convertibility, exchange rate changes, interest rate fluctuations), risks during the actual construction of a project (construction delay, cost overrun, design risk), and risks that relate to the project once it is completed and in use (production capacity risk, supply/offtake risk, government intervention). These risks are usually viewed from a variety of different perspectives, depending on one's position as a stakeholder in a project. Stakeholders often include those who are investors of equity, suppliers of debt, project contractors and consulting engineers, or the buyers or partial guarantors of the project. Given the different types of risks and the different players involved, the issue of allocating risk is central to the structuring of capital projects.

In the end, the allocation of risk is accomplished by using various financial instruments and is supported by legal agreements. Since risk allocation is central, the need to