A Perfect Storm

Industry Perspective on the Effects of COVID-19 and Proposed Regulations on the Power Sector
The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

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CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialized services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues.

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India is now set to become a US$ 5 trillion economy in the next five years and Indian industry will remain the principal growth engine for achieving this target. With the theme for 2019-20 as ‘Competitiveness of India Inc—India@75: Forging Ahead’, CII will focus on five priority areas which would enable the country to stay on a solid growth track. These are—employment generation, rural-urban connect, energy security, environmental sustainability and governance.

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A PERFECT STORM

INDUSTRY PERSPECTIVE ON THE EFFECTS OF COVID-19 AND PROPOSED REGULATIONS ON THE POWER SECTOR

VISHAL MEHTA
AARAV SINGHAL
NIKHIL NIGANIA
KAPIL DHANANIA
Globally, the pandemic has created significant disruptions, across all facets of life, and has accelerated the economic slowdown which was already setting in at the end of 2019. The Indian economy has also been impacted due to reduced industrial activity caused by pandemic-related disruptions. Given the disruption, fundamental assumptions of business have changed across industries including in the power and utility sector. While some of these changes would be transient, several others are likely to have more lasting impact. At the same time, new and proposed regulations in the power sector have been introduced focussing on power markets and improving the environment footprint of the sector. The confluence of the crisis and forward looking policy changes create a unique situation of challenges and opportunities for the stakeholders in the sector.

In this report, we analyse the effects of COVID-19 on the power and utility sector. The report focuses on both the economic impact and the implications on ways of doing business going forward. We look at the global utilities sector as a reference—and draw lessons from there for India. The report further delves on the implications for key stakeholders in the sector—the power generation and distribution companies. We will also assess potential support that the regulators and the government could provide to the sector.
Severe Global Economic Downturn Expected for 2020, some Green Shoots on Recovery Visible

The COVID-19 pandemic and the resultant lockdowns have severely impacted almost all economies with rebound to GDP levels of 2019 expected only by end-2021. (Exhibit 1).

However, green shoots of recovery are now becoming visible. BCG’s Economic Recovery Pulse Check (ERPC) tracks business activity across industrial sectors in major economies—Germany, France, UK, US, Brazil etc. The index has started showing signs of rebound to pre-COVID levels across several sectors.

EXHIBIT 1 | Global Economies Expected to Reach 2019 Levels only by End of 2021

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP Forecast Levels for 2021 Indexed to 2019 Value (Base: 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>96 - 99%</td>
</tr>
<tr>
<td>Europe</td>
<td>95 - 99%</td>
</tr>
<tr>
<td>China</td>
<td>106 - 112%</td>
</tr>
<tr>
<td>Japan</td>
<td>95 - 99%</td>
</tr>
<tr>
<td>India</td>
<td>99 - 102%</td>
</tr>
</tbody>
</table>

Source: Bloomberg; World Bank; IMF; Range from forecasts (where available) of JPMorgan Chase; Morgan Stanley; Bank of America; Fitch Solutions; Credit Suisse; Danske Bank; ING Group; HSBC; BCG analysis.

Note: As of reports dated 31 March 2020 to 21 August 2020, YoY forecasts.

1 For India, forecast is for financial year; for other countries, the forecast is for calendar year.
Healthcare is witnessing a stronger rebound due to increased demand during the current crisis. Telecom, Media & Technology (TMT), Materials & Process Industries (MPI), Financial Institutions (FI), Engineered Products & Infrastructure (EPI) and Automotive & Mobility (AM) have seen moderate recovery and are currently above previous year levels.

However, Energy, Transportation & Logistics continue to remain below pre-crisis levels (Exhibit 2).

Changes in Geo-Politics—Leading to development of Supply Chain Risks
After growing to a record high value of $18 trillion in 2019, global trade is likely to see the negative impact soon, as various countries protect their domestic industry, localize supply chains, and attract private investments.

According to estimates, trade volumes may recover to pre-COVID levels only by 2023. However, COVID-19 is expected to accelerate ongoing shifts in the global trade landscape across specific corridors. The most significant change will be in the US-China trade volumes which are expected to decline by ~$128 billion. This new reality calls for an increased emphasis on building stronger, more resilient supply chains.

Accelerated Move to the New ways of Working
The lockdown has been a game-changer for remote working and is expected to have a long-term impact on models adopted by companies globally. In a recent survey of 500+ HRDs in Europe, 85 percent of respondents were favorable towards development and continuation of remote working.

Companies are embracing remote working given its substantial long-term benefits in terms of savings on administrative and office rental costs, access to a larger workforce (tier 2 cities, gig workforce and broader talent pools), improved employee morale, and reduced attrition, among others.

In India, IT companies have led the adoption
of flexible working norms and recent moves by industry leaders suggest the adoption of remote working will intensify further. Several leading companies including TCS, HCL, Infosys, Microsoft, Tech Mahindra, Salesforce and Genpact have indicated a 25 percent-50 percent shift to remote working beyond the COVID-19 pandemic.

Rapid Increase in Digital and AI Adoption across Industries

Although it has been a priority for a while, the COVID-19 crisis has catalyzed the increase in dependence on digital leading to a massive uptick in digital activities across industries with many behavioral shifts expected to persist beyond the crisis. In a survey of business leaders post the outbreak, more than 75 percent respondents said their companies planned to further accelerate the digital agenda (Exhibit 3).

Notes
1. ERPC tracks industries in EUS (GER, FR, UK, ITA, SPA), US, Brazil, China and Japan. Index value of 100 indicates a normal activity compared to previous year’s period; Sector level activity based on 100+ data sources, for example, financial index, macro economic data, employment, sector confidence, specific data source by sector etc.
2. Survey conducted jointly by ANDRH and BCG from June 2-17, 2020; 458 respondents

EXHIBIT 3 | While Digital has Been a Priority, Companies now Plan to Further Accelerate Digital Transformation

As of 29 August 2020

Investor views on priority areas companies should aggressively invest in

| Digital Capabilities or Tech Stack | 50% |
| Research & Development | 44% |
| Marketing & Sales | 41% |
| Other Innovation | 38% |
| Mergers & Acquisition | 34% |
| Emerging Markets | 31% |
| Diversities and/or Spin-Offs | 29% |

Respondent views on priority of digital transformation post crisis

| Sector | 77% | 14% | 9% |
| Technology, Media, Telco | 82% | 14% | 4% |
| Energy | 82% | 18% | 0% |
| Industrial Goods | 81% | 14% | 6% |
| Public Sector | 75% | 17% | 8% |
| Financial Institutions | 74% | 21% | 5% |
| Consumer | 67% | 33% | 0% |
| Healthcare | 58% | 25% | 17% |

Source: BCG 11th annual investor survey 2019 (Published 12 Feb 2020); DSR Digital Transformation 2020 Survey; BCG analysis.
Note: DSR Digital Transformation 2020 Survey still ongoing with n=121; BCG 11th annual investor survey 2019 with n=251.

1 Respondents were asked what percentage of companies should be more aggressive in pursuing the following strategies for value creation.
Decline in Power & Utility Share Prices across Continents

Power and utilities have been severely impacted by COVID-9, as evidenced by the sharp decline in their stock prices globally. While some markets are recovering with the easing of lockdown measures, stock prices have remained below the levels of January 2020.

The level of recovery varied across continents, commensurate with the progress of the pandemic in each market (Exhibit 4):

- Asian utilities have seen a partial recovery

**EXHIBIT 4 | Decline in P&U Share Prices Across Continents**

*Source: Capita IQ, BCG analysis.*

*Note: Negative number indicates increase over base value.*
since peak drop-off during lockdowns. However, current prices in most markets are still well below 2020 starting levels

- With reduction in new infections and resumption of economic activity, European utilities have shown the best recovery since their peak fall in March and April. Still, quite a few stocks have not completely recovered to the Jan 2020 levels

- US utility stocks are yet to show any concrete signs of recovery since a sharp fall towards the end of March

**Multiple Challenges have Emerged for the Utility Sector**

Several demand and supply side limitations that emerged during COVID-19 have presented new challenges for the utility sector.

The sector has had to deal with two major demand-side shocks. The overall energy consumption has fallen due to reduced economic activity, and the demand pattern itself has shifted with people spending more time at home.

Similarly, on the supply side, multiple new challenges have emerged—from changes in the way of working to challenges of capital investment. For instance, restrictions on workforce mobility have pushed utilities to rethink their operating models. Companies are also facing inadequate availability of credit and increased volatility in the commodity markets. Finally, increased supply chain risks for equipment sourcing have also impacted any planned capital additions in the sector.

**Drop in energy demand**

COVID-19 lockdowns have resulted in the biggest drop in energy demand in 70 years. The International Energy Agency (IEA) has projected a 6 percent drop in annual energy demand globally for the year 2020—in absolute terms, this is equal to the total energy demand of India.

The drop in power consumption has varied across countries depending on the extent and severity of imposed lockdown measures. While demand is reviving in most markets with easing of restrictions, it has still not recovered to pre-COVID levels. (Exhibit 5)

In addition to impacting demand, reduced manufacturing activity and altered operating models for the services industry have also changed daily consumption patterns in most markets, as people spend more time at home.

**Workforce mobility limitations:**

Measures to contain the spread of virus also increase the risk of business interruptions

Several short-term precautionary measures (both mandated by governments and self-imposed by corporates) taken at the workplace to inhibit the spread of the virus are now expected to continue for long (Exhibit 6). These measures are impacting utility operations significantly. From reliability-critical activities such as substation operations and outage repair / management to commercially-critical operations such as meter reading-aspects that require large workforce deployment—have been impacted due to mobility restrictions. Balancing operations with zero safety risk for the workforce has emerged as a key challenge for the utilities.

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Mr Vineet Kumar, IRSEE, Chairman, Kolkata Port Trust, Tata Steel, while responding to a question, said, “We put in place very systematic health checks and operating protocols to ensure safety of our workforce and continue operations all through the pandemic. Additional efforts have been put to ensure that the workforce feels confident in the support provided by the company and this has helped significantly.”

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EXHIBIT 5 | Drop in Energy Demand: Drag on Power Consumption Varies Between Countries; Hardest Hit Countries Experienced ~20-30% Drop

MOST EUROPEAN COUNTRIES SUFFERED A PEAK DROP OF 25-35%

UNITED STATES WITH VARYING IMPACT OF 10-30% PEAK DROP

ASIA PACIFIC COUNTRIES EITHER WITH WIDE-RANGING IMPACT

Source: Bruegel, CENACE, EIA.gov, BCG analysis.
Note: Negative number indicates increase over base value.

EXHIBIT 6 | Measures to Control the Spread also Increase Business Interruptions

KEY MEASURES TO LIMIT VIRUS SPREAD IMPACTING BUSINESS CONTINUITY

- **Strict quarantine rules**
  - Curfews, widespread quarantine isolation for people to avoid further spread

- **No personal contact or gatherings**
  - Need to follow appropriate social distancing (e.g. 2m away from each other) - no meetings, no eating in groups, no queueing, etc.

- **Separation and reduced team sizes**
  - Critical teams (operators, HSE, etc.) have to operate separately, without a direct contact with non-critical personnel, and in smaller sizes

- **Limits on travel and transportation**
  - No collective transportation. Each individual needs to travel individually by car

- **Increased health and hygiene requirements**
  - Regular temperature checks, masks worn at all times, increased hygiene requirements (hand washing, sanitization of shared equipment, etc.)

Expected duration of measure

Source: BCG analysis.
**Credit and Liquidity Crunch**

A large portion of electricity revenue collection, whether from households, commercial or industrial, can be at risk if the lockdowns persist and impact liquidity at the consumer’s end.

- **Households**: financial pressure due to job loss, company furloughs and unemployment

- **Commercial**: reduced economic activity / quarantine restrictions impacting footfall at SMEs and specific industries such as hotels, offline retail, restaurants, etc.

- **Industrial**: slowdown in select industrial segments (for example, steel, non-ferrous metals, machinery, construction, transport and transportation equipment, textile and leather, mining) due to COVID-19

As part of COVID relief, governments globally are imposing measures that require power and utility companies to share the economic burden of the pandemic. For instance, allowing deferred payments with no / minimum interest, exemptions from disconnection for non-paying customers, reduction of tariffs, etc. (Exhibit 7).

These measures are expected to further aggravate credit and liquidity issues already mounting for power and utility companies.

**Commodity Price Shocks**

Reduced energy demand due to lockdowns has also resulted in a sharp decline in power and energy commodity prices. Apart from a fall in demand, increased supply due to the OPEC deal fallout has caused a further downward pressure on prices.

The drop in prices, however, has not been uniform. While gas and electricity saw steep drops, coal prices have remained relatively stable. (Exhibit 8)

**Supply Chain Friction**

Several manufacturing facilities across the globe have either closed temporarily or have ramped down operations as a precautionary measure (for example, Siemens Gamesa has closed two plants temporarily; ABB closed their China factory in-line with government guidance).

Suppliers are notifying companies of possible delivery disruptions due to the pandemic.

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**EXHIBIT 7 | Measures Put in Place that Force P&U Companies to Share Impact on Economy**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Description</th>
<th>Implementation probability</th>
<th>Example countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred payments</td>
<td>Delay of payment of electricity/gas bills with no/minimum interest</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Customer disconnection ban</td>
<td>Prohibition to disconnect non-paying customers</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Tariff change</td>
<td>Mandatory tariff decrease to subsidize most affected customer groups</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td>Revenue risk sharing</td>
<td>Network and generation players to share credit risk with the suppliers</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td>Taxation of P&amp;U companies</td>
<td>Changes in energy related taxes, system charges or other taxation of the regulated subjects</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td>Loosening of contract obligations</td>
<td>More flexible options to change contract obligations (e.g. reserved capacity, daily maximums, tariff class)</td>
<td>Low-Medium</td>
<td></td>
</tr>
<tr>
<td>Reconnection of disconnected customers</td>
<td>Previously disconnected residential customer to be reconnected to the grid</td>
<td>Low-Medium</td>
<td></td>
</tr>
<tr>
<td>Full forgiveness</td>
<td>Complete waiving of customer bills or government relief package to cover utility bills</td>
<td>Low-Medium</td>
<td></td>
</tr>
</tbody>
</table>

Source: BCG analysis.
Some are claiming force majeure for existing contracts or requesting the confirmation of protective measures. These problems are further amplified in cases of lean supply chains that are designed for just-in-time operations.

Segments that have lower sourcing flexibility are at greater risk. The pandemic has exposed the Photovoltaic (PV) industry’s over-reliance on China, leading the Asian Development Bank (ADB) to suggest that countries should reconsider supply chains to ensure energy transition.

The impact of COVID-19 on the Indian electricity segment largely mirrors issues faced by the power and utility sector globally. The trends observed in global markets can perhaps inform the changes we can expect in the Indian electricity segment.

On the demand side—India, like its global peers, saw a sharp decline in power consumption during lockdowns. However, there are indications of a rebound as restrictions are eased. Global sectoral recovery trends can perhaps help us understand the trajectory of potential recovery of industrial demand in India.

In particular, reduced demand has had a differential impact across plants depending upon fuel types and sources. Gas and renewables have seen increased traction due to steadier commodity prices and resilience to crisis situations.

Other supply side issues that are playing out globally are also relevant in India: geo-political dynamics are leading to an increased thrust on localized supply chains. Also, DISCOMs in India (which already had high outstanding dues) are facing an increased credit and liquidity crunch due to lower collections.

**Significant Demand Decline During Lockdown—Levels of Decline Varying Across States**

India witnessed a sharp decline in power demand since the announcement of lockdowns on 25th March 2020. The month of April saw a ~23 percent reduction in demand as commercial and industrial activity dwindled due to a complete lockdown.
With lockdowns easing in May, power demand has started to recover gradually. However, a deficit continues as most industrial and commercial establishments are still at only ~75 percent of their pre-COVID utilization levels. (Exhibit 9)

Decline in power consumption has not been uniform across the country. States with a larger share of industrial power consumption (for example, Gujarat, Odisha, Maharashtra, Chhattisgarh, Tamil Nadu, Goa, Uttarakhand, HP) have shown a higher decline in demand.

**Recovery of Industrial and Commercial Demand is Likely to Vary by Sector**

The recovery of industrial demand is likely to vary significantly by sector. It will depend on industry-specific demand and supply side factors and the evolution of the pandemic. Power and utility companies can therefore expect differential rates of recovery depending on the nature of industries in their catchment areas.

In the consumer sectors, on the other hand, there seems to be significant pent-up demand due to supply restrictions of several months. As the situation improves and economic activity resumes, several consumer sectors can expect a sudden spurt in demand which will aid recovery for power and utilities.

COVID-19 is also likely to bring about some long-term shifts in consumer behavior. This could mean that discretionary large ticket spend categories may take longer to recover given changed earnings expectations. On the other hand, sectors that are more export-oriented can expect a faster recovery.

On the supply side, resolution of three key constraints—access to affordable capital and insurance, return of migrant labor and daily wage workers, and availability of raw material and supplies, particularly imported material—can help in faster recovery. Above all, recovery is also contingent on how the pandemic evolves in India: length of the outbreak and subsequent waves and the speed of ramp-up of healthcare infrastructure.

**Exhibit 9 | ~25% Drop in Demand during Lockdown; Now Recovered to ~90% Pre-covid Levels with Easing of Restrictions**

<table>
<thead>
<tr>
<th>Month</th>
<th>Power consumption volume ('000 MU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
<td>101.2</td>
</tr>
<tr>
<td>Feb</td>
<td>105.2</td>
</tr>
<tr>
<td>Mar</td>
<td>103.6</td>
</tr>
<tr>
<td>Apr</td>
<td>108.4</td>
</tr>
<tr>
<td>May</td>
<td>109.2</td>
</tr>
<tr>
<td>Jun</td>
<td>120.0</td>
</tr>
<tr>
<td>July</td>
<td>118.0</td>
</tr>
<tr>
<td>Aug</td>
<td>116.5</td>
</tr>
</tbody>
</table>

Each of the points mentioned above can have a varied impact on the recovery rate for specific industries. Recovery rate of various sectors in other global markets (Refer Exhibit 2) can potentially serve as a good starting point to understand how the situation in India will evolve.

Mr. Peeyush Gupta, VP Marketing & Sales, Tata Steel, while responding to a question, said, “We were momentarily down from a production perspective in April, but are pretty much back to normal levels now—rapidly shifting towards export markets has helped us maintain volumes.”

Demand Shock Largely Absorbed by Coal; Gas-based Generation sees an Uptick with Changing Commodity Prices

Interestingly, reduced demand has not had a uniform impact on power generation across fuel types. Most of the demand shock had to be absorbed by coal due to differential impact on commodity prices. Gas on the other hand has seen an uptick in demand, due to the prevalence of low spot prices. The PLF for gas-based power plants increased to ~28.1 percent in Q1 FY21 as compared to 23.5 percent in Q1 FY20. (Exhibit 10)

RENEWABLES EMERGE AS A MORE RESILIENT ALTERNATIVE DURING CRISIS

Renewables have emerged as the favorable choice across all stakeholder groups—governments, investors and DISCOMs, demonstrating a much higher resilience in crisis situations.

For governments, increased adoption of renewables translates to positive impact on foreign exchange reserves as well as the environment (lower CO2 emissions and increased

EXHIBIT 10 | Demand Shock Largely Absorbed by Coal, Gas-based Power Generation more Resilient

Source: CEA, POSOCO.
water conservation) and promises better accessibility and reach across the country.

For investors, renewables have a lower risk in crisis situations as compared to conventional sources on multiple counts:

- **Lower demand risks**—drop in demand unlikely to have any impact given their merit order position.

- **Lower operational and supply chain risks**—no system-critical components on park level; uniformity of assets meaning alternate WTG and PV lines can be used as spare part supplier to other assets.

- **Lower counterparty risks and lower regulatory risks**—support for renewables is also in the interest of governments.

For DISCOMs, renewables are more price competitive, provide long-term visibility on tariffs and are more resilient to crisis. However, limited flexibility on scheduling remains a key drawback compared to conventional energy sources.

**DISCOMs under Severe Liquidity Stress due to Poor Collections**

The pandemic has exacerbated the stressed financial situation of several DISCOMs. Their total outstanding dues were already at INR ~76K crores at the close of FY20. Poor collections during the COVID period have further worsened the situation, with the dues increasing by almost 50 percent and now amounting to ~INR 115K crores as of June 2020. (Exhibit 11)

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Mr Prabir K Mukhopadhyay, Member-Secretary, DVC, while responding to a question, said, “We have taken on the mantle of putting welfare of the society at the forefront during the crisis by setting up COVID blocks in our hospital, serving the needs of the local inhabitants around the plants, honoring the labor contracts in entirety, etc. Given the reduced demand during the lockdowns, this has negatively impacted profitability but has also shown the importance of the public sector in tough times”

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EXHIBIT 11 | DISCOM dues Increased by ~50% in Three Months to ~INR 115k Cr by June ’20

Source: CEA, MoSPI, PRAAPTI dashboard.
Note: Deficit Calculation: Demand drop of 25% from 3.5 BU to 2.7 BU, ACS-ARR gap expected to increase from 0.36 to 0.6-1 range and additional hit of Rs 0.1 expected due to fixed cost waiver. ~5% efficiency drop expected in collections leading to ~50 Cr deficit.
PROPOSED REGULATIONS IN THE SECTOR

Power Market Regulation
Changes to Improve Competitiveness

The government and the regulator have played important roles in shaping the power market in India by bringing in new ideas (for example, draft PMR) or through steps to enhance market efficiency.

- **Trading regulations**: The trading norms by CERC, such as the relaxation of select trading margin caps, will help traders play a more active role in supporting the market to reach its optimal point.

- **Draft PMR**: The draft Power Markets Regulations (PMR) will enable introduction of new initiatives in the market including new stakeholders such as a clearing house and OTC platforms as well as new products such as forward contracts.

Besides promoting a single merit-order and keeping a check on market practices, the PMR also propose market coupling among power exchanges, regulate margins and develop a stronger market monitoring mechanism. Key changes in the PMR have been listed below for reference. (Exhibit 12)

- **Real-time-markets**: The launch of real-time markets (RTM) has created a new window for buyers and sellers to meet their demand-supply requirement post the ‘day-ahead market’. It presents a new opportunity for DISCOMs to meet sudden increases in demand or sell excess scheduled capacity. It also helps power generation companies to sell unscheduled power and even buy power in case of an outage. The market continues to see increasing volumes and is expected to be a big support even for renewable energy (RE) given higher surety on forecast for supply only closer to schedule. (Exhibit 13)

**Green-term-ahead market**: In August, a separate ‘term ahead market’ for green power (G-TAM) was launched with the objective to allow buyers-sellers to directly procure green power for shorter time horizons outside of PPAs (Power Purchase Agreement).

Term ahead markets enable one to one (bilateral) contracts ranging from 3 hours to up to 11 days in advance on rolling basis. In combination with RTM, G-TAM can prove to be a boon for both buyers and sellers of renewable energy.

- **Push for MBED**: While the exact mechanism is being evaluated by MoP and CERC, the implementation of MBED (Market Based Economic Dispatch of electricity), will have a big impact on both efficiency and the manner of selling and buying power.
• **Other areas** where new opportunities are emerging

  - **Supplier franchisee model:** The draft of the Electricity Act seems to create headroom for the supplier franchisee model—to enable separation of content and carriage without disrupting current norms. If executed and then adopted by states, this will bring substantial improvements in both quality of service to customers and possibly on tariffs as well. Globally, competition in retail has led to significant innovations by retailers. (Exhibit 14).

  - **Privatization of DISCOMs:** There is also a strong push for privatization of DISCOMs especially in the union territories. This privatization is proposed through the earlier Distribution Franchisee model and also through PPP / Distribution Licensee models.
EXHIBIT 13 | Volumes in RTM Consistently Rising as Compared to its Launch Month

**DAILY RTM VOLUME AS % OF DAM VOLUME**

*Period: Jun 1-Aug 25, 2020*

Source: IEX.

EXHIBIT 14 | After Retail Market Liberalization, Many Power Retailers Emerged and Offered Better Customer Experience than Incumbents

**THERE ARE MANY POWER RETAILERS IN EVERY EU STATE…**

<table>
<thead>
<tr>
<th>Competitor</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>OVO</td>
<td>32</td>
<td>39</td>
</tr>
<tr>
<td>Octopus energy</td>
<td>42</td>
<td>54</td>
</tr>
<tr>
<td>Utility Warehouse</td>
<td>55</td>
<td>55</td>
</tr>
<tr>
<td>Bulb</td>
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<td>52</td>
</tr>
<tr>
<td>Coop energy</td>
<td>51</td>
<td>51</td>
</tr>
<tr>
<td>Shell Energy</td>
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</tr>
<tr>
<td>Utilita</td>
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<td>eDF</td>
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<tr>
<td>Scottish Power</td>
<td>46</td>
<td>46</td>
</tr>
<tr>
<td>E-on</td>
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<td>45</td>
</tr>
<tr>
<td>British gas</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td>npower</td>
<td>43</td>
<td>43</td>
</tr>
</tbody>
</table>

*Source: CEER, Uswitch Energy Awards 2019.*
Measures Focused on Improving Environmental Footprint of the Sector

- **FGD for conventional power generation:** The tighter norms on NOx and SOx make it imperative for power plants to install FGDs (Fuel Gas Desulphurization) and other infrastructure in the coming years. The tightening of environmental norms is in alignment with India’s focus to bring down pollution levels. However, the development of such infrastructure will come at a substantial cost which requires support both in terms of a) Financing for the new capital expenditure for this investment and b) Ability to recover the cost via tariff increase. This would further increase the tariff for conventional power for the end customers.

Given the legacy of the power sector and differing long term contracts for conventional power plants across the states, a few factors may hinder the implementation of FGD deployment. Plants come under different regimes (Section-62 Central, Section-62 State and Section-63) and each of them requires visibility and certainty of recovery of these investments to secure the requisite funding. Further, plants with untied capacity do not have an option to pass through these costs. Such plants will require need a mechanism (via change in law or other provisions), to bring them on par with existing assets (especially if MBED gets implemented and they compete against the PPA plants to get scheduled). Limited upfront clarity and assurance on the pricing / cost recovery mechanism for each type of plant above is resulting in challenges in securing funding and hence slowing down the pace of implementation.

- **RPO:** The RPO (Renewable Purchase Obligation) mechanism is a key lever to drive off-take of renewable energy in the country. Given our federal structure, each state has defined its own norms and own method of penalizing entities which miss targets on renewable energy purchases. With the resilience renewables have shown during the crisis and the steep national targets, there is an urgent need to take a comprehensive view to ensure that overall national and state targets are aligned and the penalties / incentives are uniformly imposed across stakeholders to further ensure the envisaged growth of the sector.

Mr Rabi Chowdhury, Managing Director, Generation, CESC, while responding to a question, said, “For FGD, the CERC staff paper has already been released and the project financing should happen. But given the liquidity pressures, COVID impact and the state of the state DISCOMs, the timing of the tariff approval will play an important role in swift deployment of FGD plants”

Given most DISCOMs had already tied-up nearly all of their capacity in long term PPAs, the REC (Renewable Energy Certificate) mechanism enables the achievement of RPO targets by way of purchase of certificates. However, the REC mechanism has its own shortcomings and needs to be refined further. Removal of floor-caps and support for merchant renewables could be one initial approach to open the REC market.
OppoRtuNIties And IMplicationS for Stakeholders

The combined impact of COVID-19 and proposed regulatory reforms has resulted in a ‘perfect storm’ for the power sector. It is likely to have far reaching implications—both in the near and long term—on all aspects including business operations, investment planning, profitability, and liquidity management. (Exhibit 15)

The factors discussed above (both resulting from COVID-19 and policy changes) will have different implications for different stakeholders in the power sector. It is critical that stakeholders across the value chain—generators,

EXHIBIT 15 | Fundamental Questions for Companies to Address

<table>
<thead>
<tr>
<th>IMMEDIATE</th>
<th>NEAR-TERM</th>
<th>MID-TO-LONG-TERM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tackle immediate priorities</td>
<td>Prepare for the “new normal”</td>
<td>Pursue structural enhancements</td>
</tr>
<tr>
<td>Contingency planning and execution</td>
<td>Operational excellence</td>
<td>Accelerated digital agenda</td>
</tr>
<tr>
<td>Workforce protection</td>
<td>New ways of working</td>
<td></td>
</tr>
<tr>
<td>Critical projects stabilization</td>
<td>Restart management</td>
<td>Investment reprioritization and M&amp;A</td>
</tr>
<tr>
<td>Short term supply chain management</td>
<td></td>
<td>Supply chain and sourcing optimization</td>
</tr>
<tr>
<td></td>
<td>Regulatory agenda management</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Contract renegotiations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Active customer management</td>
<td></td>
</tr>
<tr>
<td>Crisis cash and liquidity mgmt.</td>
<td></td>
<td>Financial distress management</td>
</tr>
</tbody>
</table>

Source: BCG analysis.
distribution companies and regulators - understand the implications relevant to them and act accordingly.

Implications for Generators
Given the pandemic and its medium to long term impact on financials and ways of working, it becomes important for generators to re-evaluate conventional business practices.

In particular—the pandemic has created 4 imperatives for the generators:

- **Rethink cost structure to build resilience**
- **Rapidly adopt digital and new ways of working to ensure people safety**
- **Mitigate impact of volatility in commodity prices**
- **Source domestically—especially for renewables**

**Need to fundamentally rethink cost structure to build resilience**

If the current power market dynamics of low / stagnating demand and low-price continue to prevail in the medium to long term - it can fundamentally change the existing market structure. Merchant plants might require governmental support to survive and high marginal cost producers may be pushed into hibernation or shutdown.

To ensure sustainable profitability, generators need to fundamentally rethink current cost structures. This involves de-risking supply chains, re-thinking all operating costs, deferring non-critical capex, and aggressively managing working capital.

De-risking supply chains and increasing sourcing flexibility has now become critical to deal with supply chain uncertainties. Therefore, adjusting operating inventory levels to manage supply variability and adopting a more dynamic and agile planning process can help de-risk availability of material. Companies must also learn to operate with increased manpower flexibility—by utilizing contract / temporary staff.

Re-evaluating operating costs can help unlock operational efficiencies to ensure sustainable levels of profits. Techniques such as zero-based budgeting and re-thinking raw material specs can be employed by organizations to improve cost transparency, to rigorously re-set their cost bases and ensure costs remain lean on a long-term basis.

Generators should consider deferring all non-critical capex in the near to medium term, to help better navigate through the prevailing market dynamics. All capex decisions should be re-evaluated, setting a high bar on any new short-term capex. For all on-going contracts, companies must explore feasibility of renegotiating prices with suppliers.

Working capital management is important in a time of crisis. Liquidating excess / obsolete spares and inventory, renegotiating payment terms with suppliers and enforcing discipline in receivables management can help companies maintain liquidity.

**Revamp operations with digital and efficiency boosters to maintain profitability**

Across the world, digitization and automation have been deployed to improve operational efficiencies. Adoption of digital use cases has accelerated during COVID-19 and has emerged as a key response measure to ensure business continuity.

For generators, several uses cases have now emerged, particularly in equipment inspection and maintenance—helping to reduce downtime and maintenance costs (Exhibit 16). Ensuring adoption and long-term sustenance of these measures is critical to drive cost and operational efficiencies.

**Differential impact on commodity prices to impact merit order**

Differential changes in prices between gas and coal have resulted in a change in merit order amongst conventional sources—pushing gas before coal (Exhibit 17). With lower demand and more renewable curtailment scenarios, gas plants might see more activation in the ancillary service market to stabilize the grid.
EXHIBIT 16 | Key Digital use Cases for Generators

<table>
<thead>
<tr>
<th>Service</th>
<th>Benefits</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alarm Trigger</td>
<td>Early identification of failure</td>
<td>3-4% Failure time reduction</td>
</tr>
<tr>
<td>Equipment Health Index</td>
<td>Constantly assess operational buffers</td>
<td>3% Equipment output increase</td>
</tr>
<tr>
<td>Mobile workforce management</td>
<td>Digitalize and optimize the whole E2E field operations process</td>
<td>15-20% field work efficiency increase</td>
</tr>
<tr>
<td>Dynamic Adjustment</td>
<td>Adjust key parameters to match production profile</td>
<td>4-5% Equipment O&amp;M TOTEX reduction</td>
</tr>
<tr>
<td>Inspection Targeting</td>
<td>Target inspection to top priority assets</td>
<td>70% Inspection cost reduction</td>
</tr>
<tr>
<td>Maintenance Cycle Alignment</td>
<td>Extend maintenance cycles</td>
<td>4% Planned downtime reduction</td>
</tr>
<tr>
<td>Predictive Maintenance</td>
<td>Focus maintenance to where it matters the most</td>
<td>2-10% Preventive maintenance cost reduction</td>
</tr>
</tbody>
</table>

Source: BCG analysis.

EXHIBIT 17 | Longer-Term Demand Drop and Reduced Commodity Prices Impact Merit Order and Could Push Coal Further out of Dispatch

PRE-COVID MERIT ORDER WITH THE ACTUAL MERIT ORDER IN FEBRUARY 2020¹

<table>
<thead>
<tr>
<th>Marginal generation costs (€/MWh)</th>
<th>Market clearing price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net capacity (in GW)</td>
<td>Avg base load price of 2020</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>25</td>
<td>50</td>
</tr>
<tr>
<td>50</td>
<td>75</td>
</tr>
<tr>
<td>75</td>
<td>90</td>
</tr>
<tr>
<td>100</td>
<td>25</td>
</tr>
</tbody>
</table>

 assumptions (Pre-COVID19)
- Demand-base case profile from 2020
- Coal: 73 USD/t
- Gas: 15 €/MWh
- CO2: 24 €/t

POST-COVID MERIT ORDER WITH GAS PLANTS EXPECTED TO MOVE LEFT²

<table>
<thead>
<tr>
<th>Marginal generation costs (€/MWh)</th>
<th>Market clearing price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net capacity (in GW)</td>
<td>Avg base load price of 2020</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>25</td>
<td>50</td>
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<td>75</td>
</tr>
<tr>
<td>75</td>
<td>90</td>
</tr>
<tr>
<td>100</td>
<td>25</td>
</tr>
</tbody>
</table>

 assumptions (Post-COVID19)
- Demand reduction of 11% in industry sector in peak hours in weekdays
- Coal: 49 USD/t
- Gas: 9 €/MWh
- CO2: 16 €/t

Source: CME; Montel; BCG power market model.

Note: Battery and imports not included, Hydro pump capacity included, Average utilization of onshore and offshore wind, PV and hydro accounted (16%, 38%, 11%, 60% respectively); Market model does not consider: the plants' contract types (e.g. take-or-pay) which could make them must-runs; and gas capacities that should be saved for ancillary markets.

¹ 2020 February Base case used as Pre-COVID baseline scenario.
² Long-term merit order impact considering similar demand development as after 2008 crisis.
Implications for Distribution Companies

Like generators, DISCOMs would also need to fundamentally re-evaluate their ways of working. DISCOMs would need to explore digitization—from automation in operations to digitizing their interfaces with the customer.

In addition, DISCOMs would also need to evaluate financial options to manage increased stress on profitability and liquidity owing to the crises.

**Digitization and Automation of Operations**

Existing and new digital use cases have become increasingly relevant for DISCOMs. (Exhibit 18). Manpower constraints and mobility limitations during COVID-19 have resulted in a lot of these applications seeing mainstream adoption.

Digital is now being leveraged across network operations—inspection and maintenance, system operations, workforce management, network planning and project supervision.

**Digitization of Customer Interfaces Imperative for Service and Collections**

Like DISCOMs, customers are also challenged by lack of mobility to avail services, and redressal of grievances and other issues. Digitization of customer interfaces is now a basic operational requirement, as it brings efficiency and potential to reduce costs for the DISCOMs. As an example, during the COVID-induced lockdowns, limited meter reading by DISCOMS led to instances of “bill shocks” for many customers and further exacerbated the need to connect with the utility. Further, these interfaces provide DISCOMs the ability to connect with customers beyond the regular points of interaction and throughout the lifecycle of the customer. This creates an opportunity to develop and sell new products and services that the DISCOMs develop (e.g. rooftop solar solution, home automation products, etc).

**Privatization of DISCOMs**

With some of the underlying drivers expected to persist, the liquidity situation for DISCOMs could decline further in the coming months. Three forces at play are continuing to increase stress on the State DISCOMs. While demand is gradually recovering to pre-COVID levels, the change in consumption patterns has remained persistent and the reduced share of industrial consumption (and subsequently reduced cross subsidies) for domestic

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**EXHIBIT 18 | Key use Cases for Digital in Network Operations**

<table>
<thead>
<tr>
<th>Use Case</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digitally enabled inspections</td>
<td>Increase quality and speed of inspections</td>
</tr>
<tr>
<td>Data-driven maintenance</td>
<td>Focus maintenance to where it matters the most</td>
</tr>
<tr>
<td>Digital system operation</td>
<td>Advanced digital practices in system dispatch, load monitoring</td>
</tr>
<tr>
<td>Mobile workforce management</td>
<td>Digitalize and optimize the whole E2E field operations process</td>
</tr>
<tr>
<td>Advanced Network planning</td>
<td>Extend maintenance cycles</td>
</tr>
<tr>
<td>Digital project supervision</td>
<td>Focus maintenance to where it matters the most</td>
</tr>
<tr>
<td></td>
<td>30% Reduction in customer interruption</td>
</tr>
<tr>
<td></td>
<td>15% Preventive maintenance cost reduction</td>
</tr>
<tr>
<td></td>
<td>4-5% Equipment O&amp;M TOTEX reduction</td>
</tr>
<tr>
<td></td>
<td>15-20% field work efficiency increase</td>
</tr>
<tr>
<td></td>
<td>1-2% Less spend or postponement of CAPEX</td>
</tr>
<tr>
<td></td>
<td>1-2% CAPEX reduction</td>
</tr>
</tbody>
</table>

Source: BCG analysis.
tariffs is leading to lower overall revenue. This is further exacerbated by continued lower collections owing to the lockdowns & risk of infections. Lastly, in fulfilling the role of the welfare of the citizens, relief measures around electricity tariff reduction are further impacting the profitability of the DISCOMs.

With the financial situation expected to continue on this path in coming months, governments may increasingly consider privatization of state owned DISCOMs as a potential avenue to relieve the stressed cash flow situation through private investment that can help introduce the much needed capital investment towards operational efficiency, loss reduction and network upgrades to bring back profitability in the DISCOMs.

Implications for Regulators and Government

Policy and regulatory support for forward-looking changes in the sector

As discussed in Section 4, there are several forward-looking policy changes that have been introduced or are being actively considered for the sector. These changes will undoubtedly increase the competitiveness and efficiency of the companies within the sector and benefit the sector in the long run.

However, these changes are fundamental changes to how the sector operates (and will operate going forward). We have a diverse set of GenCos and DISCOMS and their equally diverse set of assets, contracts and operating practices. Making such fundamental shifts will not be easy for these companies and there are likely to be many teething challenges. The federal nature of the power sector both aids the execution and at the same time increases the complexity.

The policy makers and the regulators will need to be the guiding light for the stakeholders across the sector to realize the intended benefits for our country. They will be required to play a very active role in providing clear policy guidance to the stakeholders in their states and adapting the policies with a view towards smoother and faster implementation. Further, all the allied issues (like funding, tariff revision, etc) that emerge going forward, will need to be addressed in a holistic manner to remove any friction points that are bound to emerge when such fundamental changes are introduced into any system.

Judiciously crafted economic stimulus for the sector recovery

The economic stimulus for the power sector needs to achieve the twin objectives of supporting the sector recovery and ensuring job creation while doing so. Further, the speed at which the program can be implemented on ground will be critical for the recovery to be effective in supporting our country’s recovery from the crisis. needs to be carefully crafted while balancing job creation with speed of implementation.

Many of the “green” energy options provide a great avenue for the economic stimulus to achieve its multiple objectives. Significant potential to move towards green recovery while balancing these priorities. Large-scale renewables, green public transport and industrial efficiency improvement programs are a few examples of areas where the potential for job creation is high and the initiatives can be implemented faster than other large projects.

Mr Rajanvir Singh Kapur, IAS, Managing Director, West Bengal Transport Corporation, while responding to a question, said, “There is high consciousness towards the environmental effect of transportation. We are already taking significant steps towards reducing our carbon footprint through electric buses and electrification of other transport modes.”
The COVID-19 pandemic and the resulting economic upheaval have created winds of change across multiple sectors—with the power sector being no exception. Mirroring trends seen globally—the Indian power sector has seen significant decline in overall demand. While the industrial and commercial sectors have globally shown signs of recovery, the recovery in India is expected to vary by segment. In spite of the fall in gas prices (and resulting decline in power costs), DISCOMs continue to be under severe liquidity stress—a problem that has only been further exacerbated by poor collections.

Given these challenges, stakeholders across the power value chain—from generators to regulators—would need to reevaluate current business practices.

Generators in particular would need to re-think their cost structures to build resilience. Digital and automation have emerged as focus areas in this regard globally. Equipment inspection and maintenance have been thrust areas for adoption—helping to reduce downtime and maintenance costs. Generators would also need to be cognizant of the impact that commodity price variance has created on the merit order of dispatch. Fall in gas prices has seen it replacing conventional coal-based power in multiple instances.

DISCOMs in turn would need to revalue their ways of working. To mitigate liquidity pressures DISCOMs would need to aggressively explore digitization of their customer interfaces to shore up collections. However, with declining financials of state governments, privatization of state DISCOMs might also need to be considered.

Adjacent to the changes foreseen for DISCOMs and generators—the government and regulators would also need to be thoughtful in the impact that any economic stimulus might create. Regulators would need to walk the tightrope of balancing the need for job creation with speed of implementation. The pandemic has however also created an opportunity for regulators to push the green agenda and bring in long-lasting changes to improve the efficiency and competitiveness of the sector. The entire sector will look to them as the guiding lights to help them navigate the crisis and build on the fundamental changes being introduced to increase the sector’s performance and contribution to the country’s economic recovery and growth.

While the way ahead is likely to be challenging, the pandemic also presents the power sector an opportunity to fundamentally re-structure itself and emerge far more resilient on the other side of the crisis.

CONCLUSION
Boston Consulting Group published other reports and articles on related topics that may be of interest to senior executives. Recent examples include:

- **Decentral energy and DISCOMs**  
  (Aug, 2019)

- **How the Wind Industry Can Harness Gale-Force Change**  
  (Dec, 2018)

- **Digital in Power**  
  (Aug 2018)

- **The Digital Energy Retailer**  
  (April, 2018)

- **Will Your Offshore Wind Strategy Sink or Swim**  
  (Jan, 2018)

- **Finding the Sweet Spot in Distributed Energy**  
  (May, 2017)
NOTE TO THE READER

About the authors
Vishal Mehta is a Managing Director and Partner of BCG India.

Aarav Singhal is a Principal in the firm’s Mumbai office.

Nikhil Nigania is a Principal in the firm’s New Delhi office.

Kapil Dhanania is a Consultant in the firm’s Mumbai office.

For Further Contact
If you would like to discuss the themes and content of this report, please contact:

Vishal Mehta
Partner and Managing Director
BCG Mumbai
+91 22 6749 7228
mehta.vishal@bcg.com

Aarav Singhal
Principal
BCG Bengaluru
+91 22 6749 7510
singhal.aarav@bcg.com

Nikhil Nigania
Project Leader
BCG New Delhi
+91 124 459 7257
nigania.nikhil@bcg.com

Kapil Dhanania
Consultant
BCG Mumbai
+91 22 4273 3704
dhanania.kapil@bcg.com

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Mr Rabi Chowdhury
Managing Director, Generation CESC

Mr Prabir K Mukhopadhyay
Member - Secretary DVC

Mr Vineet Kumar, IRSEE
Chairman Kolkata Port Trust

Mr Rajanvir Singh Kapur, IAS
Managing Director West Bengal Transport Corporation

Mr Peeyush Gupta
Vice President, Steel Marketing & Sales Tata Steel Limited

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