MANAGING PROJECTS IN GOVERNMENT RESTRICTED ECONOMIES

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ABSTRACT

Nowadays, Worldwide projects are affected by various types of risks, difficult to quantify. When dealing with countries, where for Political or Economic reasons Government controls are established, risks to investors increase in principle for reasons of trust in authorities or changing laws from time to time, the speed on how money operations take place and adaptation to Cultural attitudes, among others.

In the following paper, the author describes how business is carried out in a Developing Country like Venezuela, a major Oil producer, responsible for about 15% of U.S. gasoline needs, where Exchange Control Regulations were established since 2003, and how to take opportunities in such restricted economy.

Introduction

Risk Analysis is one of the most relevant challenges for Project managers. Traditionally, policies like equipment overdesign or applying cost contingencies based on common sense were the usual approaches adopted to reduce risks. With the changing situation caused by the steep increase in Oil prices, inflation patterns and the revolution and development of computerized devices to control technical and economic variables in practically all life activities, managing risk has become a most difficult subject to analyze when dealing with the evaluation, start-up and development of any significant task.

If to the principles of studying risks, we add the effect of location and what kind of economic control by Governments is established, Risk Analysis becomes more complicated. In this paper, some of the most important aspects or managing projects are studied and analyzed, with special reference to a restricted economy as it happens in Venezuela, where strict currency controls were imposed by the Government.

Venezuela. Background, and Economy.

Venezuela is a country located in the North of South America, having a large coast line with the Caribbean. Its geographical situation has easily allowed it to trade different products with North America and Europe, and because of its close distance with the Panama Canal, with other South American countries and the Far East.

Traditionally, after its independence from Spain, Venezuela had an Agricultural Economy, mostly based of Coffee, Cocoa, Sugar Cane and Cattle. In the beginning of the 20th Century, Oil appeared and people working in crop fields started leaving their jobs to work either in Oil fields or in the most important cities, attracted by better wages and better conditions compared to those in the rural areas. Oil revenues, exponentially larger than those coming from agricultural sources made and kept the country for all these years, virtually monoproducer of Oil, and with the foreign currency generated, a very able place to import any needed good from abroad.

Until 1973, Oil was extracted and commercialized by foreign companies like Exxon, Shell and Mobil. It was then nationalized and owned 100% by the Government, who also marketed this product and its derivatives. As an interesting point, most of Venezuelan fuels, as Crude Oil or derivatives are exported to the U.S.A., being responsible for about 15% of its Gasoline needs.

Since the nationalization of Oil, as Government had budgets based on estimated Oil sales abroad, steep changes in its price made different Political authorities take necessary steps to keep a healthy economy, and to assure the needs to import most critical products to the population, The easiest thing to do when Oil prices were down was to restrict the economy by putting into practice Exchange Control Regulations. This has been faced three times in the last 20 years, first in 1983, then in the beginning of the nineties and then since 2003, in spite of having Oil prices at a fairly high level and more than 30 billion U.S. dollars in international reserves.

During these three constrained peaks in the Venezuelan history, foreign investment has steeply decreased, but some investors see this as new opportunities to compete in a more advantageous way, taking advantage of an apparent high risk situation. In the following section, some advantages and disadvantages of investing in a restricted economy are discussed in more detail by analyzing the most relevant factors involved in risk analysis practice.

Government regulations and Project investment

When the last Venezuelan Government came into power in 1998, Venezuela was a free economy. There was total freedom to exchange the local currency (Bolivar) into any hard currency needed to buy products not manufactured locally. After year 2003 until now, strong measures were taken and for the first time in this Century, laws to enforce Exchange Control Regulations were established, even with the menace for prison to anyone trying to get foreign currency in the black market.

In a parallel way, a very efficient system to sell foreign currency was put into practice and managed by the Foreign Currency Administration Control Office, Attached to the Ministry of Economics called CADIVI. In this way, companies seeking US Dollars or Euros mostly, had to register through CADIVI and if all requirements were fulfilled, in a matter of two weeks. Official registration was likely to take place place.

Normally, for every purchase order that entered into the Government automated system, when open credit is allowed by external suppliers, in a matter of 48-72 hrs. approval to import can be obtained. Once goods arrive into the Country, original documents after Clearing Customs have to be handed to the Government Office. Normally, within 7 weeks, payment to the external supplier is carried out through an operating bank selected by the Customer, in the corresponding currency. If payment takes place through Letter of Credits or Cash in advance, it takes longer to get the approval to import because of internal procedures within the computerized structure. It is important to know that payment gaps do not interfere with clearing Customs.

Some effects of Control Regulations in Managing Projects.

At first sight, it can be thought that such complicated way of doing business can be a snag to import goods/machinery from abroad. However, this situation cannot be generalized. Some of the most critical aspects when dealing with Risk Analysis are discussed with special reference to the restrictive economy considered in this case study. It is important to indicate at this stage that some of these effects also come out from the fact that Venezuela is a developing country where new business opportunities are occurring.

1.- Technological Risk.

Normally, we refer to technological risk to the possibility that a project could fail if production technology is used inefficiently. A typical graph showing this risk is indicated in Fig. 1. Some factors affecting this risk include:

<u>How modern is the technology utilized</u>. In this aspect, adding the fact that many restricted economies occur in developing countries, new equipment use offers a great potential to investors because they can be ready for "Green Field" projects, many times a better alternative than debottlenecking.

<u>The organization capacity to make processes with a correct repeatability.</u> This can be overcome by using the right automation devices that can adapt to processes being considered. Nearly everywhere in the world, this can be available and Venezuela is no exception.

<u>Availability of Equipment and Technical skills</u>. Well linked with the previous point discussed. This does not always happen, but training is always possible. In countries like Venezuela, companies developing projects are bringing expert technicians to train local workers to operate new equipment, who would then multiply their knowledge to others. This has been successfully experienced in the Oil and Iron processing Industries, and experiments are being held in the Farming sector.

<u>External suppliers to the projects</u>. This is a very important issue to potential investors. If economies are not restricted, any payment honoring to external suppliers occurs in an independent way. When economies are under currency exchange regulations, Government figure makes the obligation that the customer must pay to the external supplier, otherwise, laws can be strong, and with a very small cost, an external supplier can ask a plant to be shut-down until payment is received. This situation would also include a heavy fine for the customer, and in extreme cases, jail penalties.

2. Marketing Risk

Different from the technological risk, marketing risks are out of companies control, hence, they are regarded as Non Systematic risks. After a project starts operation and sales, it can simply fail for marketing conditions leading to sharp decrease on significant revenues.

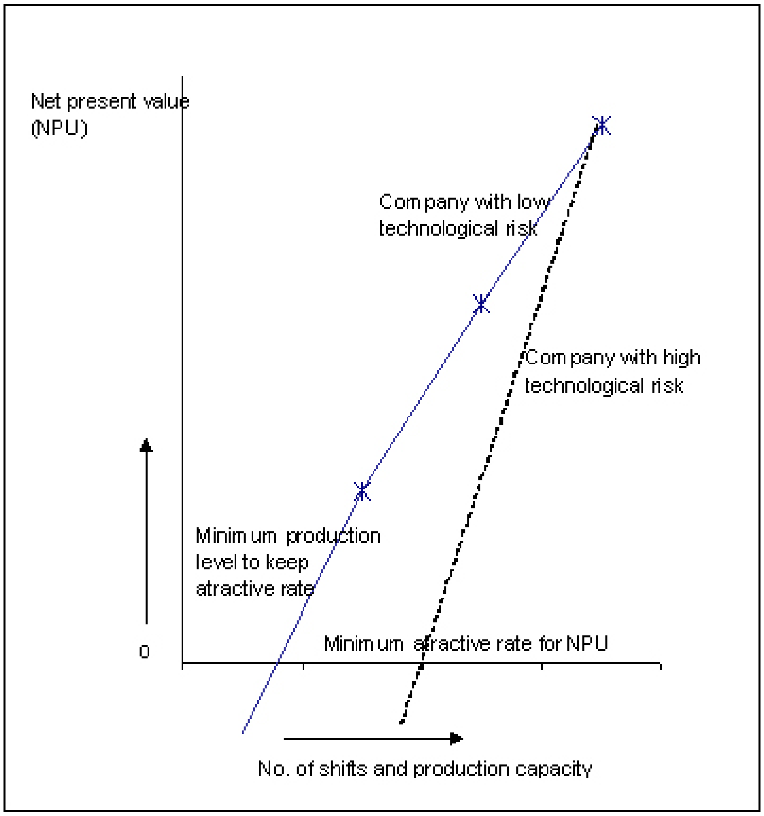

FIGURE 1. Technological Risk

When Government controls occur, the natural risk takes place if prices are also fixed. This type of situation happens in products of primary needs, such as Food and Pharmaceuticals. However, experience has shown that these problems can be solved by the dialogue with Officials before setting projects leading to a decrease in the use of foreign currency and an increase in employment levels in the country being considered. In occasions, these situations have been improved by changing internal structures to lower costs. A case recently happened with three local Sugar mills that set an Integrated Corporate Purchasing Structure to reduce expenses.

The common way to minimize the Marketing risk lies on the analysis of optimistic and pessimistic scenarios. Pessimist ones are obviously the most important to analyze in order to think about actions to take in the worst case. Managing the Marketing risk would then mean to anticipate situations to avoid going to a bankruptcy. In addition to all sales efforts, including publicity and the treat and training of salesmen, close contact with Government Institutions are a key to make Marketing risks as low as possible. Actions to take would rely on efforts in Public Relations as well as in administrative actions.

Another important aspect in sales relies on exports and currency value. One of the problems faced in Venezuela is that no system of export bonuses has been implemented, as in other Latin American countries, such as Chile and Brazil. Export sales are carried out using the Official rate of exchange.

Complaints have been put by local private companies and the case is being studied by Official people involved in macroeconomical affairs.

3.- Financial risk.

The most evident risks involved when financing projects include increases on interest rates. If rates increase above those planned by working groups, failure probabilities increase. If we also put currency devaluation as a possible fact, debts in foreign currency increase risks. In the case of Venezuela, it is important to know that Government has been carrying out significant efforts to make banks put down interest rates. In addition, in the last year, the gap between Official rate of exchange against the American Dollar and parallel rates has not been of more than 20% difference. Therefore, from a financial point of view, a restricted economy like the Venezuelan one may offer some advantages to foreign investors. This can now be done because Oil revenues have increase steeply and International reserves are above 30 Billion Dollars. The large revenues and strong currency, if the time comes, would nullify some of the negative effects of all the risks indicated.

The Cultural impact in Project Management.

The Venezuelan case as a restrictive economy cannot be complete without analyzing the Cultural effects when managing projects. Serious studies carried out have shown that Venezuelans, in order to try being successful managers, have the following tendencies:

POWER ORIENTATION. In Venezuela, there is a well traced orientation to get and keep the power, above achieving objectives. This is very typical of our Latin Culture, shared with Countries like Italy and Spain.

AFFECTIVE ORIENTATION. Local surveys have shown that affective relations are of much concern to Venezuelans. People like working with others, not always effectively but in a non conflictive atmosphere. When something wrong occurs, the tendency is to hide the problem, and it can be difficult to find people responsible for a non desired result or accident. It is important to get friends above the rules.

OBJECTIVE ORIENTATION. Allows to complete the equilibrated triangle of human motives. Excellent results can be achieved in terms of goals because they can be a way to get more affiliation with others and power.

From the Governments point of view, the last 50 years have shown that due to the excessive economic dependence of only one product, as it is Oil, Venezuela has generated a very changing environment to Project Management applications. In addition, a Socialist tendency to handle Official Organizations has degenerated in Paternalism, Populism and re-distribution of wealth through public employment and concessions. These factors, together with the high critical poverty index of more than 50% of the population, has contributed to classify Venezuela as a high risk country level.

Conclusions.

Risks can be found everywhere in the World, whether economies are restricted or not. In restricted economies, investors tend to reject working on Project developments because conventional approaches indicate higher risks. They may be right in some cases, but could loose opportunities for not carrying out in-depth Project Feasibility studies and overlooking some of the advantages that restricted economies offer for new developments, particularly in developing countries.

Together with all the standard aspects needed to study when dealing with projects, in restricted economies, Cultural and Political factors must also be considered to succeed in setting profitable projects in order to adapt in a more efficient way new technologies, and overcome non systematic risks.