

PPPs: Modalities & Benefits

PPP Modalities

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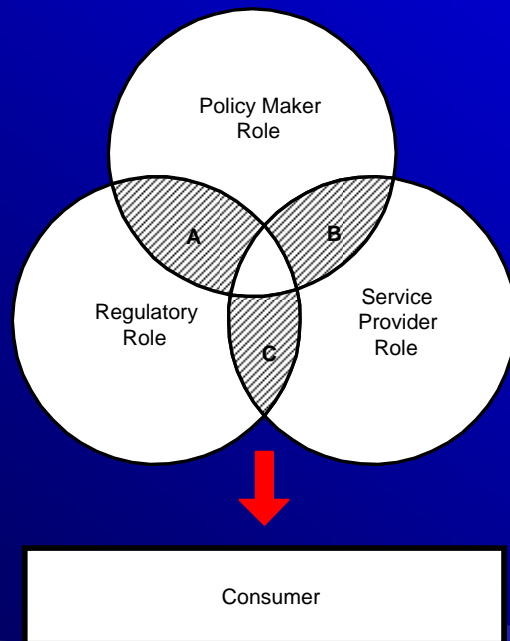


What are Public Private Partnerships (PPPs)?

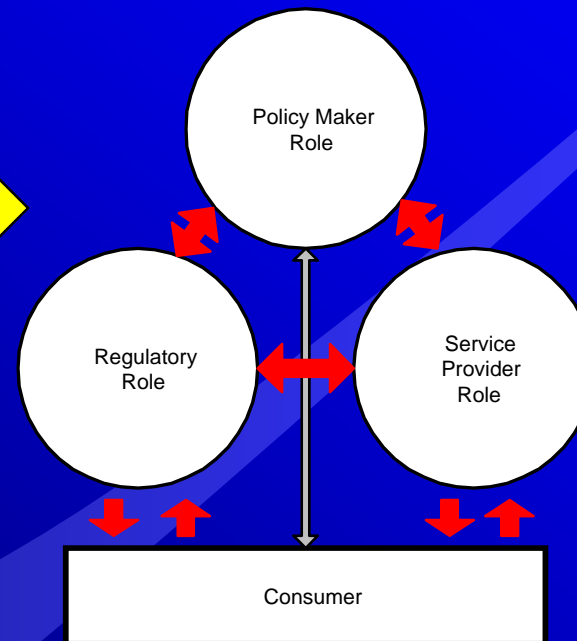
- PPPs are **contracts** between the Government and a private sector supplier that define performance and outputs, as well as risks to be borne by each parties
- PPPs came out of the '**commercialization and privatization process**' initiated in 1980s. Increased **private sector participation** was sought to support:
 - Removing **conflict of interest** between Government's role of defining policies, regulating industries, and providing outputs/public services
 - Allowing outputs/services to be provided by in a **competitive market** where the private sector has strong **incentives** to perform due to profit motives
 - **Reducing the Government's expenditure** commitment, to support macroeconomic stability, and allow public expenditure to be reallocated to other priority sectors such as health and education
- Governments pursued this program by **commercializing state owned enterprises (SOEs)**, and where markets were competitive and privatizing those firms
- For **infrastructure** and some other service sectors, it became apparent that **competition not always feasible** due to economies of scale and sunk costs
- *PPPs an **intermediate solution** implemented to **engage as well as regulate private sector providers***

PPP Development - Stage 1: Unbundling of Public Sector Functions

Vertically Integrated Monopoly



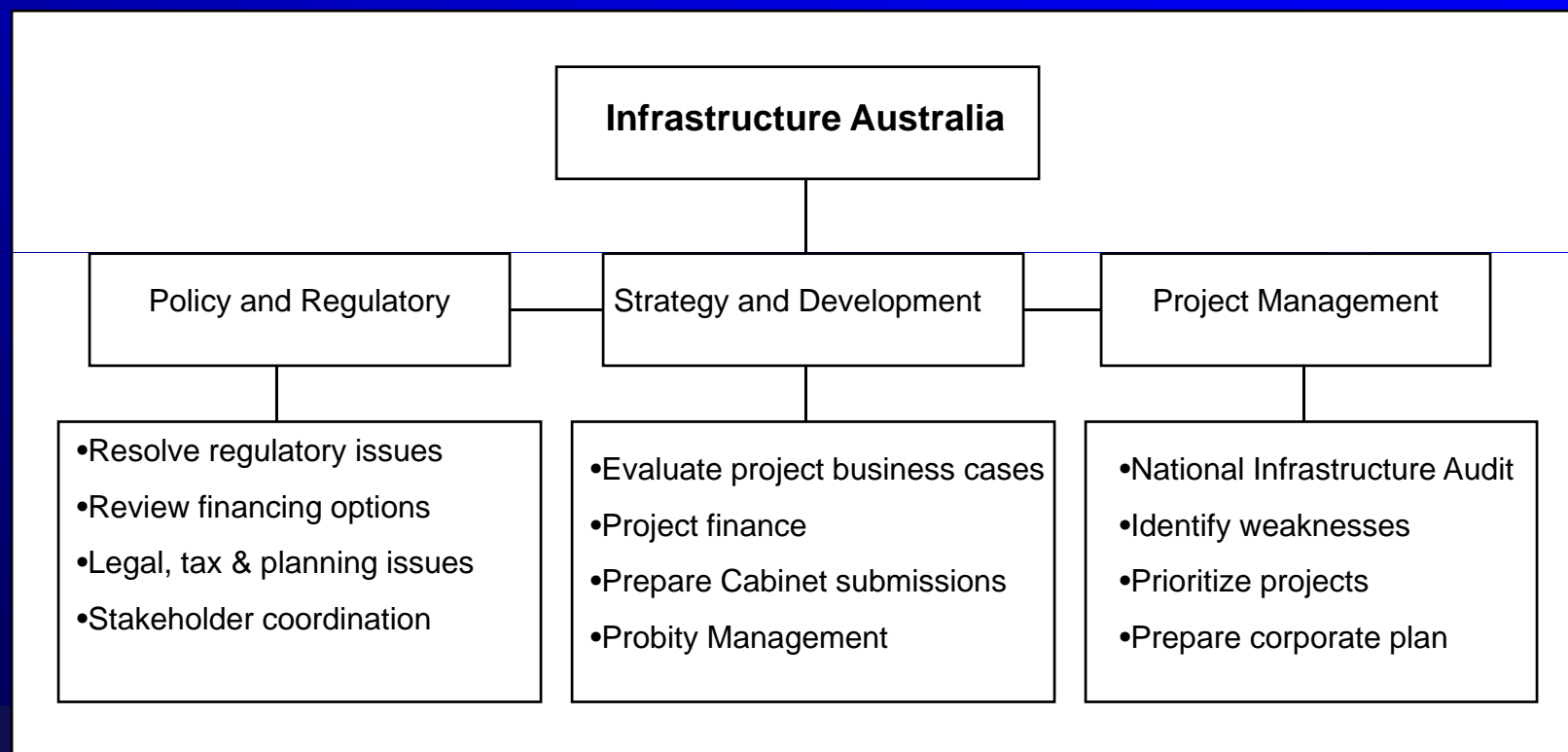
Competitive Supply



Public Sector Functions

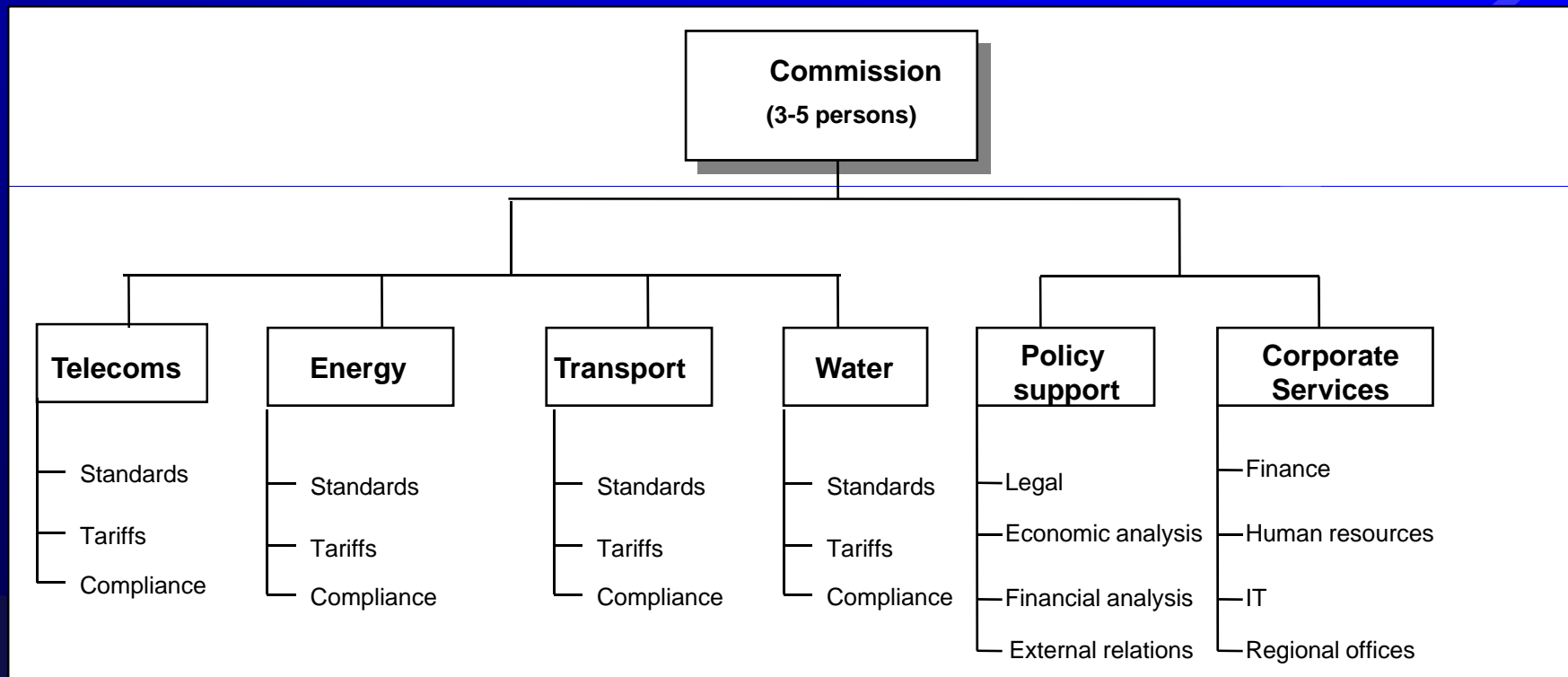
- **Reporting to Parliament and Public**
- **Coordinating programs** with other line agencies, NGOs, consumers, producers and other stakeholders
- Defining **regulatory standards** for output quality and tariff setting and oversee performance of independent regulators
- Developing **industry roadmaps** identifying opportunities from improving efficiency by unbundling to increase competition and aligning capacity with expected demand
- **Developing projects** for implementation by Government/SOE or with the private sector through a PPP agreement

Australian Model – Infrastructure Australia



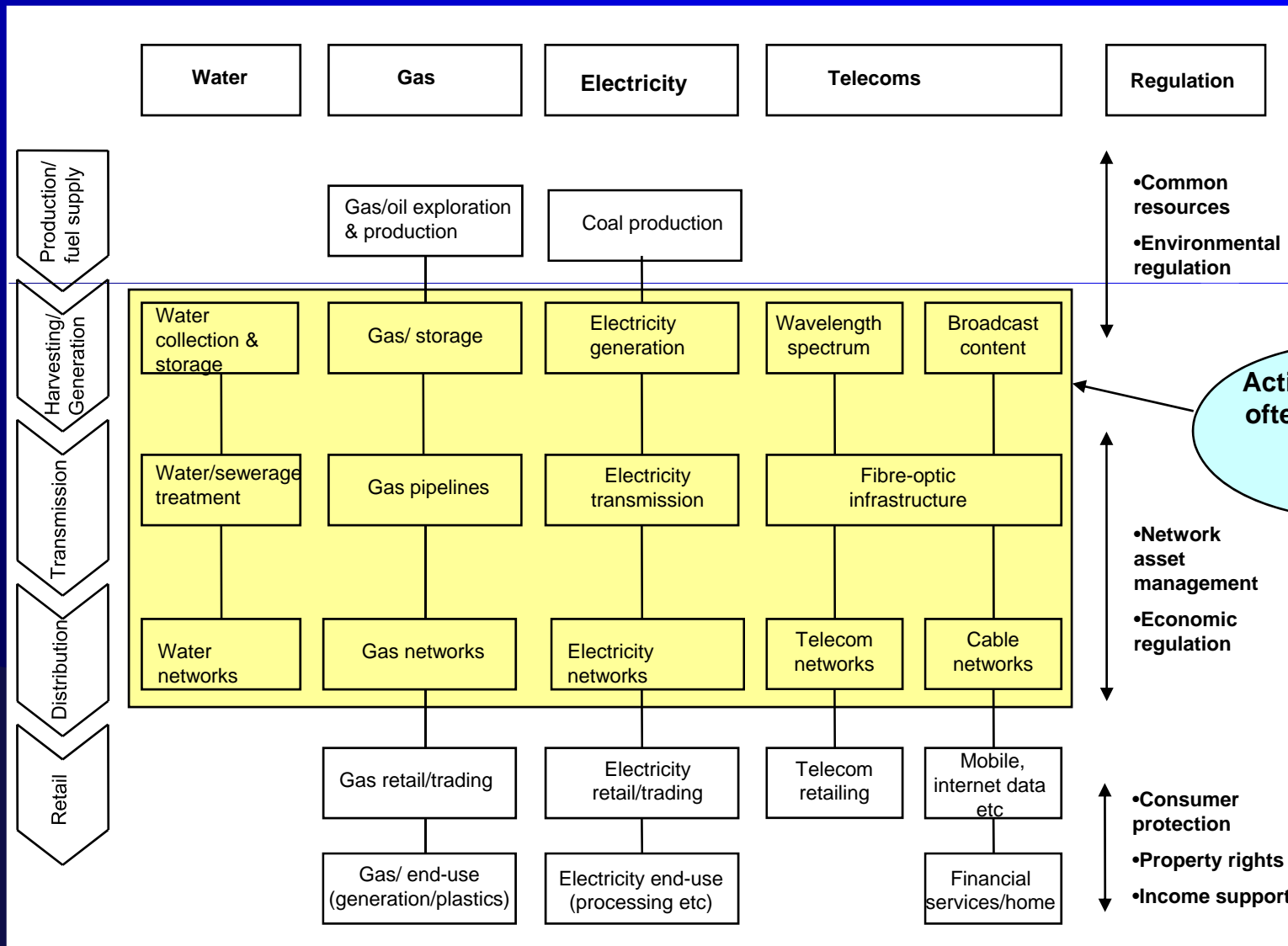
Single Ministry with Responsibility for Coordination of National and Sub-national Programs across all Sectors

PPP Development - Stage 2: Establishing an Independent Regulator



Role of Single or Multi Regulator/s is to define and oversee performance/quality standards and tariffs

PPP Development - Stage 3: Unbundling of Service Provision



With Unbundling of Service Provision – PPPs being Implemented for ...

- **Energy/Power** generation, transmission, and networks
- **Air and Sea Ports** infrastructure and services (with regulation and use of concessions to ensure competitive access)
- **Rail** including light rail for urban transit
- **Roads** with and without tolls
- **Water** collection/storage, treatment, and networks
- **Schools and Hospitals** where infrastructure is built, operated and maintained by the private sector

PPPs Advantages

- **PPPs provide a means of mobilizing funds** to develop the vast backlog of investment required in infrastructure, which Governments cannot finance due to fiscal constraints.
- **Time and cost savings** can be substantive:
 - The UK Treasury reported that 70% of non PFI projects were delivered late, compared to 20% of PFI projects. 73% of non PFI projects were over budget compared to 20% of PFI projects^a
 - In Australia, **PPP projects** generated project **cost savings of 30.8%** and were completed on average **3.4% ahead of time**, whereas traditional projects were completed **23.5% behind time**^b

^a *PFI Strengthening Long Term Partnerships*, HM Treasury, 2006

^b *Performance of PPPs and Traditional Procurement in Australia*, The Allen Consulting Group and the University of Melbourne, 2007

PPPs – Critical Design Elements

- Defining monitorable contract performance standards to ensure **delivery of quality outputs and services**
- Ensuring **minimisation of total life costs** of outputs – not just initial capital cost
- **Transferring or sharing risks** that cannot be managed by the Government
- **Incentivising third party revenue and delivery of outputs** by linking payments to revenue/profits (DBFOs) and outputs/service performance

PPPs – Flexibility

- Governments can maintain ownership of the asset and service delivery rights, with PPP/concession agreements **rights can be transferred** to the private sector **for a finite period**
- PPP/concession agreements enable **competition to be introduced over time**, particularly where competition is considered difficult due to economies of scale and sunk costs
- PPP contractual framework for managing risks can support **certainty to regulate quality of outputs and service performance** and **flexibility to accommodate unforeseen events**

Private Sector Participation – Options

1. Borrowing from, or selling a Minority Equity Interest to, the private sector through an SOE
2. Using a Service Contract to purchase short term services
3. Bringing in private sector expertise through a Management Contract
4. Leasing an asset to the private sector, and receiving a payment for its use
5. Creating a Concession and allowing the private sector to produce outputs, usually with a regulated tariff mechanism
6. Divesting of the business to the private sector through a direct sale, or under license

PPP Modalities – Resource and Risk Allocation

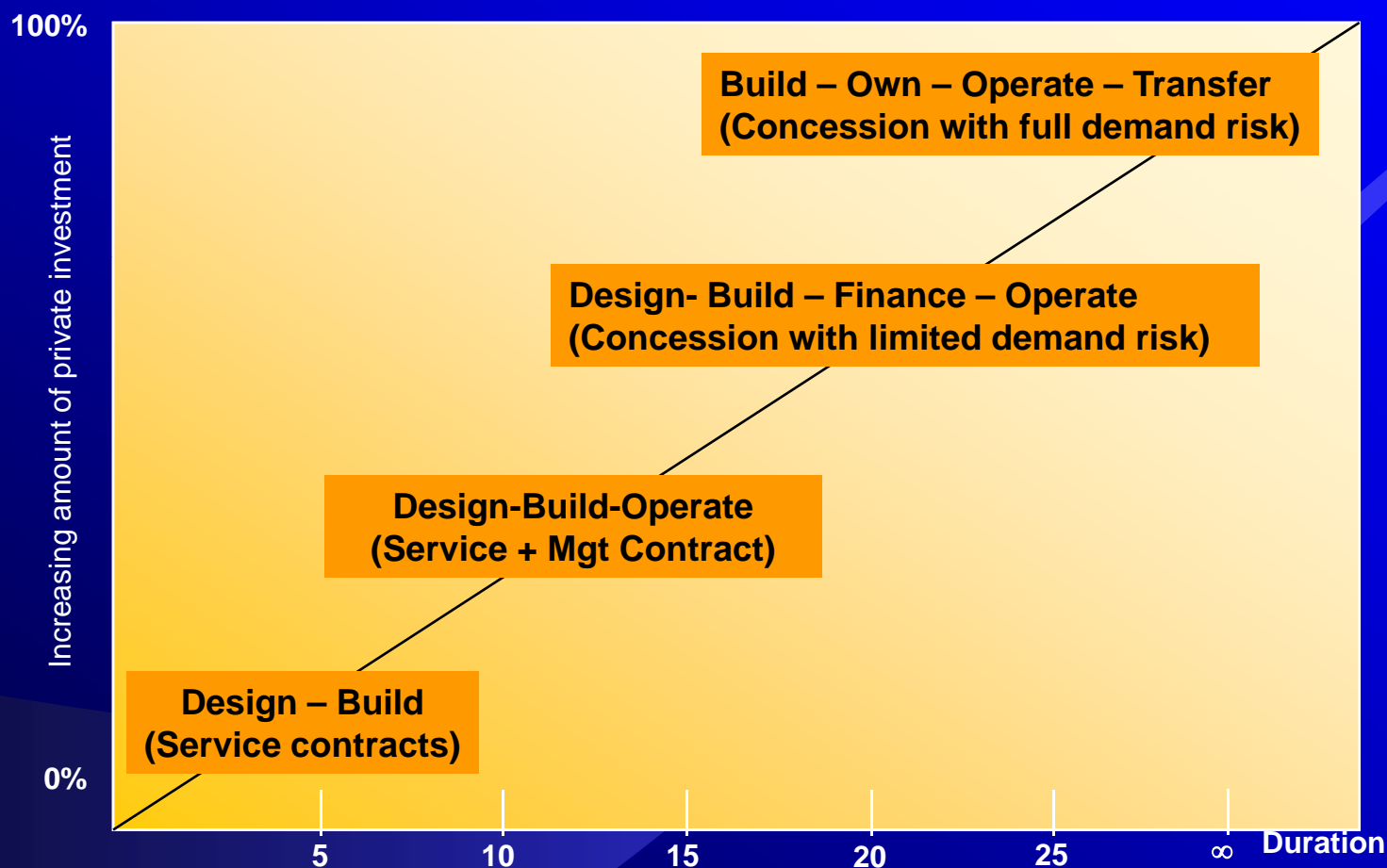
PPP Option	Labor	Capital investment/ Financing	Contract Duration	Output Risk (quality, minimum unit costs & secure availability)	Investment Risk (competitive return on equity capital)
Service contract	Private	NA	1 – 2 years	Public	Public
Mgt. Contract	Private	Public	3 – 5 years	Public	Public
Operating Lease to Private Sector	Private	Public	5 – 15 years	Public	Public
Concession (DBFO)	Private	Private	15 – 25 years	Public	Private
Concession (BOOT)	Private	Private	15 – 25 years	Private	Private

PPPs – Main Modalities

1. **Service contracts** are short term and in infrastructure relates to services such as project design, construction, operations and/or maintenance
2. **Management contracts** provide only private sector management expertise and no capital, primarily used when Government wants to access private sector management and technology skills to operate facilities
3. **Operating leases** provide only private sector management expertise and no capital, used when the Government does not wish to sell an asset
4. **Design Build Finance Operate (DBFO) Concessions** are a primary form of PPP, used where the Government purchases the outputs, often using a fixed annuity payment, plus a performance bonus, such as in the road sector. This type of PPP is relatively new in emerging economies, but it is becoming increasingly important in countries such as India.
5. **Build Own Operate Transfer (BOOT) concessions** are the other main form of PPP, used where the Government does not purchase the outputs directly, but tariffs are typically set by a regulator, such as in the power sector. This is the most common form of PPP used in emerging economies to date.

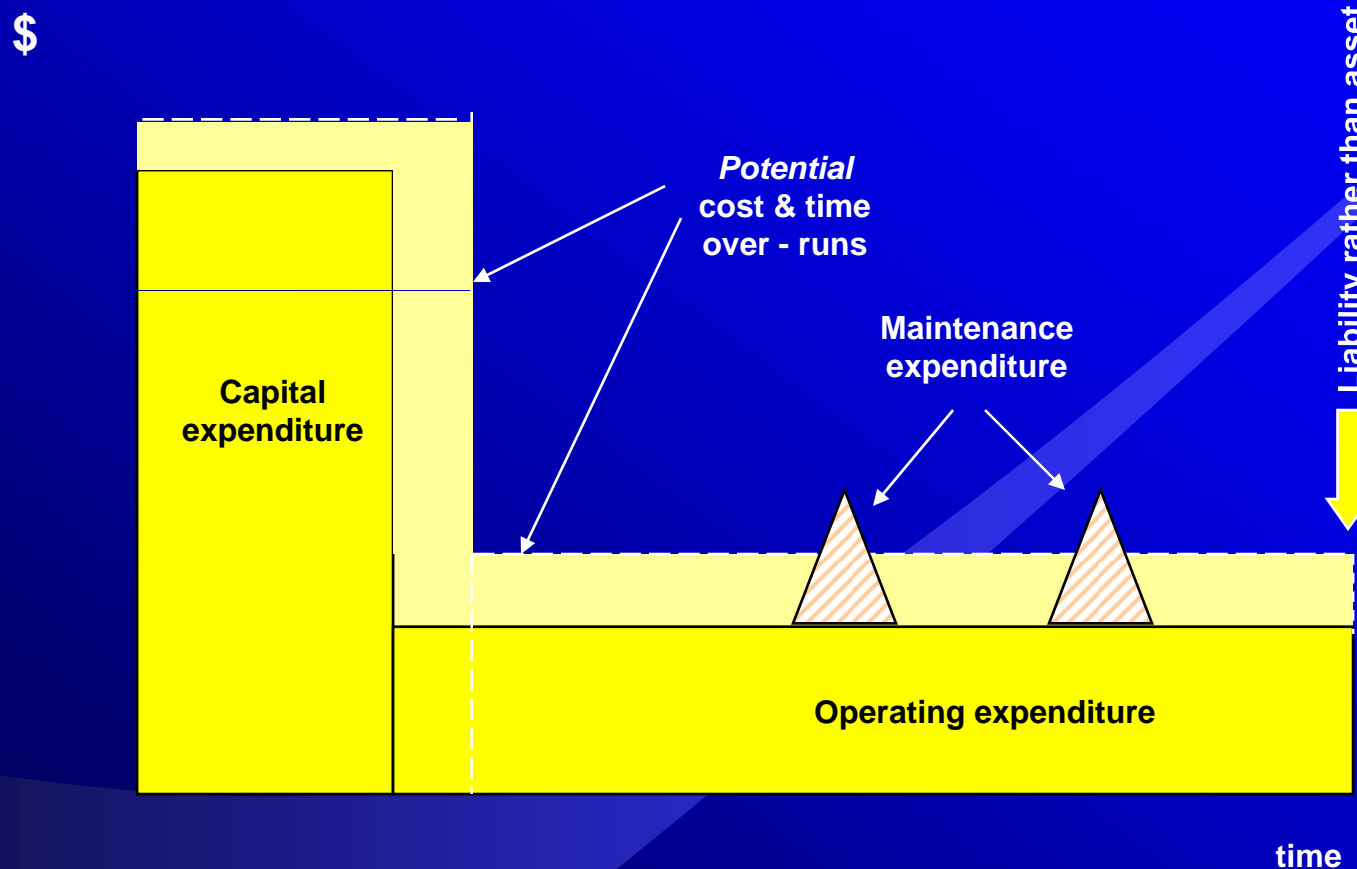
Each modality offers increasing levels of financial risk being assumed by the private sector service provider with increasing regulatory risk for the Government

PPP Options offer – different Duration, Financial Benefits and Risks



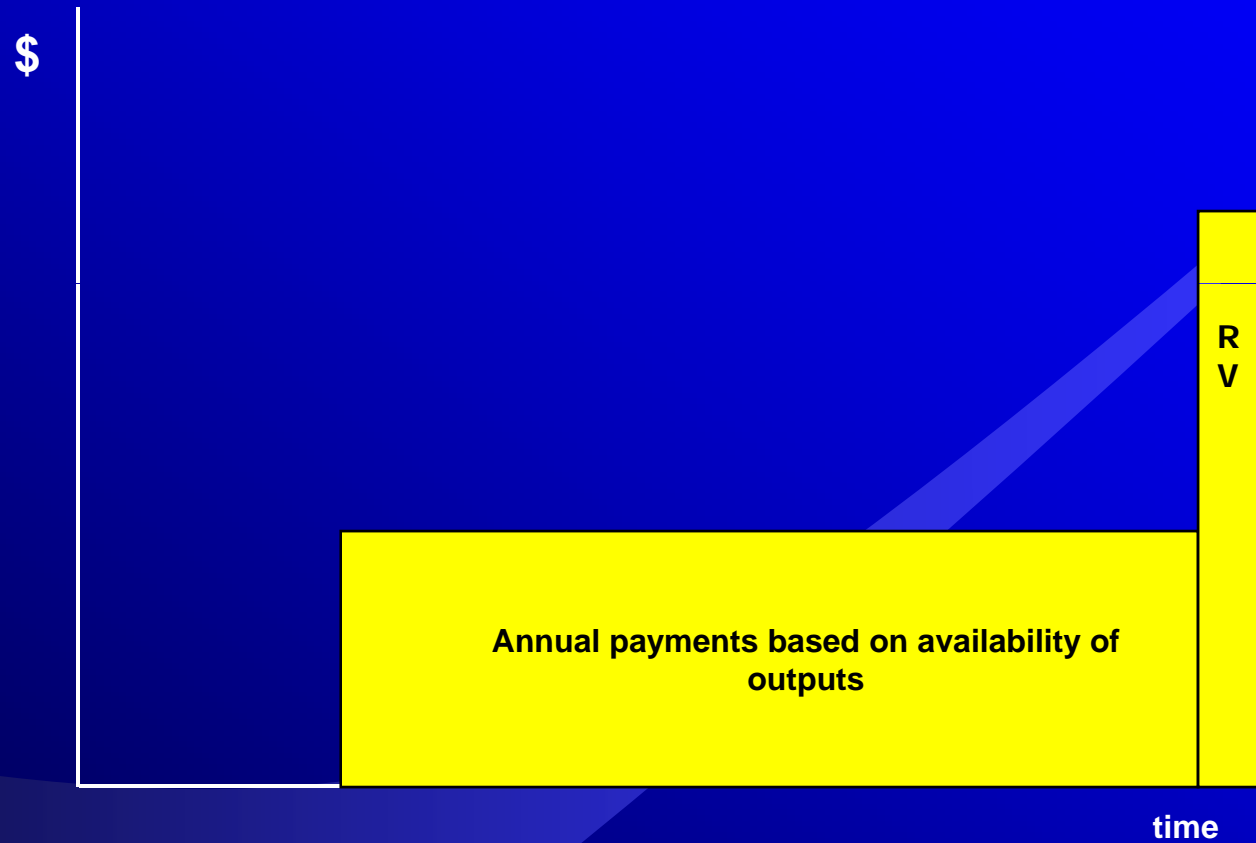
Increasing level of delegation to private sector, potential cost savings, revenue enhancements, and regulatory risks

Government Cash Flow: Traditional Procurement



Public Sector Delivery: large capital outlay with high risk of project cost and time over-runs, and excess maintenance cost

Government Cash Flow: DBFO Concession



PPP Delivery: No initial capital outlay with total project cost and predefined maintenance regime defined by contract

PPPs not for all Projects

- Projects need to be **sufficiently large** to justify transaction costs which can be as high as 3% of bid costs compared to 1% for traditional procurement^a
- Need to be able to clearly **define the outputs**
- There is a need for a **competitive private sector** that can bid and credibly supply the service
- Need to be able to demonstrate that **value for money** is being achieved
- **Risks** need to be allocated, based on the principle that the party who assumes the risk is in the best position to manage that risk
- **Government** needs capacity to design the outputs, evaluate and negotiate bids, have financial capacity to pay for the outputs (in the case of DBFOs), to independently regulate tariffs, and to monitor and enforce contract performance through transparent dispute resolution mechanisms

^a Adam Smith Institute, 1996

With Careful Preparation PPPs have Enormous Potential for Infrastructure

- Growing use of PPPs in developed and emerging economies to gain access to private sector resources, reduce project costs, and improve service delivery
- PPPs are also important as a regulatory instrument
- Project size and design, risk allocation, and affordability are key determinants of successful PPPs
- PPPs require specialized institutional arrangements and coordination with broader sector reforms