



Strengthening Private Sector Participation for Infrastructure in the Pacific Region

PPP Value Added and Value for Money

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 **ERNST & YOUNG**

Quality In Everything We Do

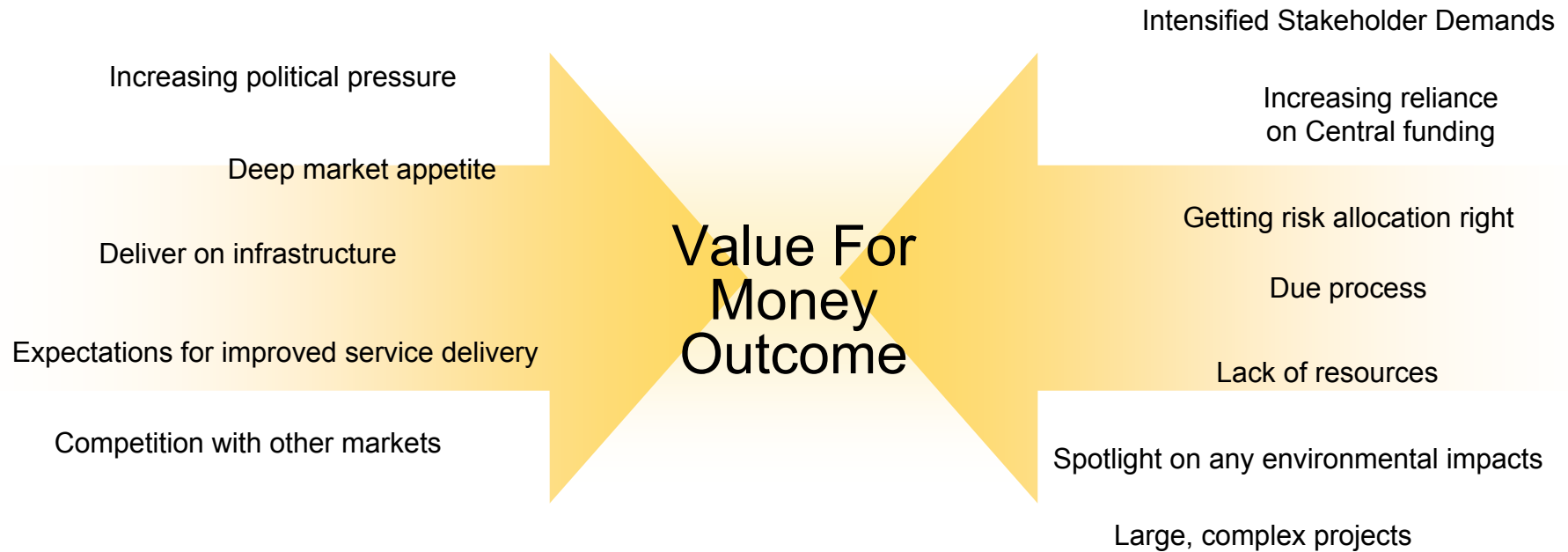
Agenda

- ▶ The PPP Option
- ▶ Key Success Factors and Benefits
- ▶ VFM Definition
- ▶ VFM Drivers

Infrastructure – Conflicting Market Forces

Velocity

Complexity



Accelerate

Brake

PPPs require new approach to Infrastructure delivery

- Co-ordinate Infrastructure planning and provision
- Create an appropriate regulatory regime to send the desired investment signals
- Maximise the value of private sector delivery
- Develop market capacity
- Educate the community
- Shifting mindsets

Key Benefits of PPP

- Deliver value for money, through synergies from combining design, construction and operation
- Takes spending out of political cycle; Moves away from annual budget considerations
- Creates long-term approach to provision of public services
- Only used where it makes sense
- New facilities provided efficiently and effectively
- Innovation and spread of best practice
- Standards maintained over life of project
- Flexibility of approach to allow consideration for all types of infrastructure

Critical Success Factors for PPP

- Properly resourced and committed Government team
- Effective procurement process
- Effective management and allocation of risk
- Clear specification of outputs
- Project affordability – no free goods!
- Understanding that private sector needs to make an appropriate level of return!
- Contract structure and payment mechanisms

What's in it for Government?

➤ Pricing and timing certainty

- ▶ **Only 24% of PPPs late** vs 73% for Public projects
- ▶ **Only 22% of PPPs over budget** vs 73% of public projects
- ▶ These risks borne largely by private sector

➤ Better Services

➤ Innovation

➤ Catalyst for Public Sector reform

- ▶ Allows public sector to focus on key activities that are consistent with long term policy priorities.

How can Private Sector maximise benefits?

- Focus on the **SERVICES** to be provided
- **INNOVATE** – particularly in design and exploiting **SYNERGIES**
- Form **ALLIANCES** not just consortia
- Maintain **COMPETITION**, including the financing

Value for Money (VFM) – Definition

The optimum combination of whole life **cost** and **quality**
(or fitness for purpose) to meet the user's requirement”

(OGC, 2002b p6)

- ▶ **VFM does not mean lowest cost**

Value of Money – Drivers

Risk Transfer

Whole of Life
Costing

Output
Specification

Competition

Performance
Measurement

Private Sector
Management Skills

VFM Drivers – Risk Transfer

- ▶ Optimal risk allocation of project risk is a key driver
 - ▶ Optimal allocation occurs when risk is allocated to the party able to manage it at lowest cost
 - ▶ Private sector is often better placed to manage project risks
- ▶ Transferring risk is not an end in itself
 - ▶ Inappropriate transfer of risk will lead to ‘premium’ pricing
 - ▶ PPP process seeks to identify the optimal allocation through the tender process by assessing market’s view of the cost of risks
- ▶ Typical risks transferred include:
 - ▶ Design and construction of the asset
 - ▶ Long-term asset performance
 - ▶ Service delivery

VFM Drivers – Whole of Life Costing

- ▶ PPP projects require bidders to consider whole life costs of a procurement
 - ▶ For assets, capital and lifecycle costs
- ▶ Whole of life focus drives efficiencies
 - ▶ Design to minimise overall costs e.g. use of construction materials to lower replacement or maintenance costs
- ▶ Whole of life approach transfers cost risks to private sector
 - ▶ Government insulated from higher maintenance or lifecycle costs over life of project
- ▶ Avoids backlog maintenance issues into the future – asset maintenance “locked in” for many years

VFM Drivers – Output Specification

- ▶ PPP projects typically use output specification
 - ▶ Define deliverables in terms of outputs required rather than inputs
 - ▶ Reconfigures asset procurement to services procurement
 - ▶ Allows bidders to consider best way of achieving outputs
- ▶ From Government's perspective, evaluation will focus on services delivered rather than the inputs
- ▶ Output focus complements the performance-based payment regime typical for PPP projects

VFM Drivers – Performance Measurement

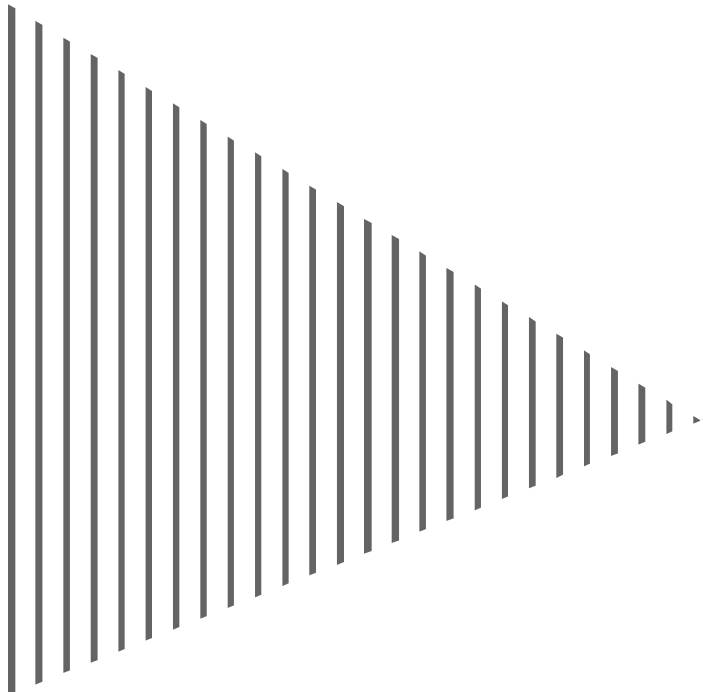
- ▶ Many PPP projects use Payment Mechanisms to incentivise performance
- ▶ Key Performance Indicators (KPIs) are used to set benchmarks for contractor performance
- ▶ Penalties applied for sub-standard performance
- ▶ Represents major change in traditional delivery approach
- ▶ Examples include:
 - ▶ Maintenance rectification periods
 - ▶ Minimum standards of cleanliness etc.

VFM Drivers – Private Sector Management

- ▶ Role of the bid Sponsor is important to value for money delivery
- ▶ In Australia, investment banks or contractors can play such a role
- ▶ The ability to successfully manage and motivate sub-contractors to perform is key
- ▶ Due diligence prior to financial close also beneficial
- ▶ These skills are hard to transfer to a public sector environment
- ▶ Different incentives for public and private sectors

VFM Drivers - Competition

- ▶ Use of competitive tension key part of any procurement
- ▶ Competition in key areas of PPP projects can reduce costs:
 - ▶ Construction and service provision contracts
 - ▶ Debt margins and equity returns
 - ▶ Pricing of risk
- ▶ Process typically structured to generate competition:
 - ▶ Initial process to short list strongest bidders
 - ▶ Request full proposals from 2-4 bidders
 - ▶ Maintain competitive tension for as long as possible



Thank you

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