P3, 3P, PPP
Public Private Participation

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Definition of PPPs in India

- The Department of Economic Affairs (DEA) defines PPPs as:

- **PPP** means an arrangement between a government or statutory entity or government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or related services for public benefit, through investments being made by and/or management undertaken by the private sector entity for a specified time period, where there is a substantial risk sharing with the private sector and the private sector receives performance linked payments that conform (or are benchmarked) to specified, pre-determined and measurable performance standards.
Physical infrastructure, such as roads, water and sanitation networks, and transportation systems, involve large investments that can put a strain on the public purse. This strain is especially great for countries, such as India, whose economies are undergoing rapid development and urbanisation and have a great need for expanded infrastructure.
Public-private partnerships (PPPs) are increasingly being used by governments and public sector authorities throughout the world as a way of increasing access to infrastructure services for their citizenry and economies at a reduced cost.
Origins.

Pressure to change the standard model of public procurement arose initially from concerns about the level of public debt, which grew rapidly during the macroeconomic dislocation of the 1970s and 1980s. Governments sought to encourage private investment in infrastructure, initially on the basis of accounting fallacies arising from the fact that public accounts did not distinguish between recurrent and capital expenditures.

The idea that private provision of infrastructure represented a way of providing infrastructure at no cost to the public has now been generally abandoned; however, interest in alternatives to the standard model of public procurement persisted. In particular, it has been argued that models involving an enhanced role for the private sector, with a single private-sector organization taking responsibility for most aspects of service provisions for a given project, could yield an improved allocation of risk, while maintaining public accountability for essential aspects of service provision.
• The objectives of a PPP in infrastructure are to:
• Increase the availability of infrastructure services
• To do so with greater efficiency (lower cost for the level of services provided) than could be achieved using the traditional public sector approach
• PPPs make this possible because:
• PPPs allow access to the substantial financial resources of the private sector
• PPPs enable the public sector to benefit from private sector technical expertise, experience and efficiency
• PPPs enable the public sector to transfer project-related risks to the private sector
A PPP typically has the following characteristics:

- The private sector is responsible for carrying out or operating the project and takes on a substantial portion of the associated project risks.
- During the operational life of the project the public sector’s role is to monitor the performance of the private partner and enforce the terms of the contract.
- The private sector’s costs may be recovered in whole or in part from charges related to the use of the services provided by the project, and may be recovered through payments from the public sector.
- Public sector payments are based on performance standards set out in the contract.
- Often the private sector will contribute the majority of the project’s capital costs, although this is not always the case.
- It will often be necessary to build or add to existing assets in order to meet the infrastructure needs of the economy and users. However, an important part of the infrastructure PPP concept is that:
A PPP is focused on outputs, and the outputs of the PPP are infrastructure services, not infrastructure assets.

The reason for the focus on outputs and services rather than assets is to encourage efficient use of public resources and improved infrastructure quality.

A PPP brings the public and private sectors together as partners in a contractual agreement, for a pre-defined period (eg. 30 years) matched to the life of the infrastructure assets used to provide the services. The private partners (investors, contractors and operators) provide specified infrastructure services and, in return, the public sector either pays for those services or grants the private partner the right to generate revenue from the project. For example, the private partner may be allowed to charge user fees or receive revenue from other aspects of the project.

The best PPPs will have the public and private partners working together to build and sustain a long-term relationship that is of benefit to all.
Why use PPP?

- PPPs offer the public sector potential cost, quality and scale advantages in achieving infrastructure service targets. However, PPPs are different to the traditional public sector route and these differences require adaptation of approach and capabilities in the public sector. There are also some new costs associated with PPPs.
The advantages of PPP

- Access to private sector finance
- Efficiency advantages from using private sector skills and from transferring risk to the private sector
- Potentially increased transparency
- Enlargement of focus from only creating an asset to delivery of a service, including maintenance of the infrastructure asset during its operating lifetime
- This broadened focus creates incentives to reduce the full life-cycle costs (ie, construction costs and operating costs)
- All of these provide strong reasons in favour of using PPPs in India and elsewhere.
Access to private sector finance

India has a very large infrastructure need and an associated funding gap. PPPs can help both to meet the need and to fill the funding gap. PPP projects often involve the private sector arranging and providing finance. This frees the public sector from the need to meet financing requirements from its own revenues (taxes) or through borrowing.
Higher efficiency in the private sector
A well designed and managed PPP should take advantage of the potential for efficiency gains from using the private sector.

Increased efficiency is driven by three features of well designed PPPs:
1. The allocation of risk and the associated performance rewards and penalties create incentives in the PPP contract that encourage the private partner to achieve efficiency at each stage of the project and to introduce efficiency improvements where possible. By shifting risk onto private partners the public sector is able to limit its own exposure to cost escalation.
2. PPPs can be structured so as to create a whole-of-life focus in which the private partner designs the project to take account of the link between construction and operation so that the cost will be minimised over the project’s lifetime. A private partner who in addition to designing and building the project will also provide the ongoing operations and maintenance management has an incentive to ensure that the design and construction facilitate efficient O&M.
3. Competition is introduced during the bidding stage, thereby bringing the benefits of market procurement (this is a kind of “competition for the market”). As long as the project is well specified in terms of the output requirements (rather than specifying the inputs) then each private sector bidder has an incentive to produce an innovative response and to minimise cost.
The key to increased transparency and reducing opportunities for corrupt practices is the release of information to the public domain, for use in the media and by interested and concerned individuals, NGOs, and the private sector participants themselves.

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Complexities in PPPs

- A PPP is not a panacea for all the public sector’s funding and infrastructure problems and PPPs are not always the most appropriate procurement option.

- The following are noted complexities in PPPs. Most of these can be minimised under certain circumstances and through careful management of the PPP design by the Sponsoring Authority. This requires public sector capacity (experience and expertise) to manage the PPP process.
The PPP project must be clearly specified, including allocation of risk and clear statement of the service output requirements. The long-term nature of PPP contracts requires greater consideration and specification of contingencies in advance.

The tendering and negotiation process is a costly exercise. Transactions advisors and legal experts will typically be required.
Contract uncertainties

- PPPs often cover a long-term period of service provision (eg. 15-30 years, or life of the asset). Any agreement covering such a long period into the future is naturally subject to uncertainty. If the requirements of the public sponsor or the conditions facing the private sector change during the lifetime of the PPP the contract may need to be modified to reflect the changes. This can entail large costs to the public sector and the benefit of competitive tendering to determine these costs is usually not available.
Enforcement and monitoring

- Once it enters the construction and operation phases, the success of the PPP from the public perspective will depend on the ability of the sponsor to monitor performance against standards and to enforce the terms of the contract.
Ideally, a project should be procured as a PPP on the basis of a clear demonstration that it provides value for money (VFM) compared with public sector procurement. However, it is difficult to demonstrate VFM in advance due to uncertainties in predicting what will happen over the life of the project and due to a lack of information about comparable previous projects.
Commercial viability

- Commercial viability is crucial if the project is to attract a private partner. For a project to be commercially viable does not mean it cannot receive some financial and other support from the public sector.
Value for money and risk allocation

- In order for PPPs to offer value for money (VFM) to the Public Sponsor, the Government, the State, or the municipality, the often higher costs of private financing must be more than offset by the greater efficiencies offered by private sector construction and operation and the reductions in risks borne by the public sector. This means there must be effective risk transfer to the private sector.

- Careful and appropriate risk allocation between the public and private partners is a critical focus of PPP design to achieve value for money.

- If private partners do not bear the risks that are under their control, their incentives for efficiency will be weakened and PPP benefits may be reduced.
The Constitution of India divides the responsibility of legislation between the National Parliament and State legislature bodies. The Seventh Schedule of the Constitution of India contains a Union List, a State List and a Concurrent List. The Indian Parliament is competent to make laws on matters enumerated in the Union List. State Legislatures are competent to make laws on matters enumerated in the State List. While both the Union and the States have power to legislate on matters enumerated in the Concurrent List, only Parliament has power to make laws on matters not included in any list.
The key areas that have been included in the Union List are ports, airports, railways, national highways, inland water transport, telecommunications, oilfields and mineral resources.

The key areas that have been included in the State List are police services, prisons and corrective facilities, regulation of local governments, public health and sanitation, state highways, city roads, water supply and irrigation.
India’s experience with PPP in a serious manner started from 2006 onwards. PPP requires private sector participation in public asset creation through money, technology and management. For this, several models inviting their participation were launched for different projects.

These models operate on different conditions on the private sector regarding level of investment, ownership control, risk sharing, technical collaboration, duration of the project, financing mode, tax treatment, management of cash flows etc.
Build Operate and Transfer (BOT):

- This is the simple and conventional PPP model where the private partner is responsible to design, build, operate (during the contracted period) and transfer back the facility to the public sector. Role of the private sector partner is to bring the finance for the project and take the responsibility to construct and maintain it. In return, the public sector will allow it to collect revenue from the users. The national highway projects contracted out by NHAI under PPP mode is a major example for the BOT model.
Build-Own-Operate (BOO):

- This is a variant of the BOT and the difference is that the ownership of the newly built facility will rest with the private party here.

- The public sector partner agrees to ‘purchase’ the goods and services produced by the project on mutually agreed terms and conditions.
Build-Own-Operate-Transfer (BOOT):

- This is also on the lines of BOT. After the negotiated period of time, the infrastructure asset is transferred to the government or to the private operator. This approach has been used for the development of highways and ports.
Build-Operate-Lease-Transfer (BOLT):

- In this approach, the government gives a concession to a private entity to build a facility (and possibly design it as well), own the facility, lease the facility to the public sector and then at the end of the lease period transfer the ownership of the facility to the government.
Lease-Develop-Operate (LDO):

- Here, the government or the public sector entity retains ownership of the newly created infrastructure facility and receives payments in terms of a lease agreement with the private promoter. This approach is mostly followed in the development of airport facilities.
Rehabilitate-Operate-Transfer (ROT):

Under this approach, the governments/local bodies allow private promoters to rehabilitate and operate a facility during a concession period. After the concession period, the project is transferred back to governments/local bodies.
DBFO (Design, Build, Finance and Operate):

- In this model, the private party assumes the entire responsibility for the design, construction, finance, and operate the project for the period of concession.
Private Operation

- The private party assumes the entire responsibility for the design, construct, finance, and operate or operate and maintain the project for the period of concession.
Management Contract:

Here, the private promoter has the responsibility for a full range of investment, operation and maintenance functions. He has the authority to make daily management decisions under a profit-sharing or fixed-fee arrangement.
Service Contract:

- Service contract: This approach is less focused than the management contract. In this approach, the private promoter performs a particular operational or maintenance function for a fee over a specified period of time.