Introduction to Public Private Partnerships As A Business Model

e-Governance Project Lifecycle
Agenda

- Introduction to PPP
- Introduction to PPP models
- Structuring considerations in a PPP
- Risks and challenges in PPP
- PPP in e-Governance implementations in India
Defining Public Private Partnerships

A public private partnership or PPP involves:

- Government and private sectors working together to deliver infrastructure or services that are traditionally provided by government.
- Private financing, implementation and management of key infrastructure and with the primary objective of improving public services.

PPP is a generic term for the relationships which are formed between public bodies and the private sector with the aim of introducing private sector resources and/or expertise to provide and deliver public sector assets and services.
Defining Public Private Partnerships

Traditional Model of Public Service Delivery

Private sector was supporting the government in delivery of public services to citizens

Shift in Public Service Delivery

Private sector is participating in public services delivery to citizens
Various Models For Private Sector Participation

- Conventional
- Outsource
- PPP
- BOO(T)
- Privatise

Risk Transferred to the Private Sector
PPP Basics

PPPs are concerned with services, not assets

- The government does not need to own infrastructure to deliver services
- PPPs are a procurement option, not a novel method of developing public infrastructure
- PPP policy sits alongside other procurement methods – ie conventional, outsourcing, leasing etc.
- Suitable to some public projects, not all projects
- PPPs are not “new money”
- Service outputs must be paid for, whether directly (e.g. user charges) or by appropriation
- Must therefore be affordable – either to users (user charges) or to the Budget
More about PPP

- The government retains **political responsibility/accountability** to deliver services for the community;

- The government defines the **timeframe** in which the services must be delivered; and **the quality and quantity** of services needed;

- The private sector delivers the services **and finances or part finances the project**;

- Private sector remunerated through **services charges/transaction fees/gap funding**;
More about PPP

- A mid/ short-term relationship is established, typically (in governance) between 3 to 5 years, depending on the nature of the facilities, assets or services to be delivered;

- The different functions of system design, development, maintenance and operation are integrated to release the synergies between them and discourage low-capital/high-operating expenditure solutions;

- Risks are allocated between the public and private sectors;

- There is an emphasis on output-based specifications;
Benefits of PPP

- Allowing the government to concentrate on its core activities
- Allocation of Risk and Responsibility where it can be best managed
- Unity of responsibility leading to improved delivery of public services
- Reduced lifecycle costs of a project;
- Quantifying more accurately the costs of service delivery;
- Reduced risk of cost overruns;
- Increased revenues;
- Maintaining an efficient government and a lean civil service;
- Spreading the government’s capital works expenditure over the life of a project;
- Invoking private sector skills, experience, access to technology, and innovation.
What Distinguishes PPP?

- **SHARING OF RISK**
  - Private party bears significant financial, technical and operating risk
  - Promise of a sustained service
  - Financial rewards to private sector linked with output

- **CAPITAL INVESTMENT AND CAPACITY BUILDING**
  - Significant private capital deployed for citizen services or use of already developed capabilities
  - Building capacities for servicing at a faster pace

- **JOINT OWNERSHIP**
  - Well defined roles and responsibilities
  - Clarity in ownerships and other terms
  - Full control by Government over key data
  - Concessions and Guarantees from and to the Government

The principle of risk transfer is fundamental for all PPP type transactions.

What does this mean?

- Clarity in
- Full control by Government over key data
- Concessions and Guarantees from and to the Government
Typical Project Risks

- Land acquisition, planning and permissions
- Design
- Construction
- Commissioning
- Latent defects
- Operating performance
- Operating and maintenance costs
- Third party revenue

- Demand (volume)
- Residual value
- Inflation
- Regulatory
- Taxation
- Force Majeure
- Changes in requirement
Risk Allocation

Key considerations for risk allocation:

- Who is best placed to reduce the probability of risk occurring?
- Who is best placed to manage the cost of risk if it does occur?

Minimizing the expected cost of risk is crucial for maximizing returns.

Risks should be allocated to the party best able to understand and manage them.
Risks should be allocated to the party best able to understand and manage them.

PUBLIC
- LAND ACQUISITION, PLANNING / PERMISSIONS
- DEMAND RISK (?)
- CHANGES IN REQUIREMENTS
- LATENT DEFECTS (EXISTING)

SHARED RISK
- INFLATION
- REGULATORY
- TAXATION
- FORCE MAJEURE

PRIVATE
- DESIGN AND CONSTRUCTION
- COMMISSIONING
- OPERATING AND MAINTENANCE COSTS
- OPERATING PERFORMANCE
- LATENT DEFECTS (NEW)
- THIRD PARTY REVENUE
What Should Private Partnership Bring?

- **Real financial benefit** and a better utilisation and allocation of public funds;

- **Development of efficient public infrastructures/projects** in shorter terms than otherwise;

- **Ensure** of good quality public services;

- **Economic growth** and boosted direct investment by private sector

- **Efficient control** over the formation of long-term private sector liabilities;
Role Of Government In PPP

- Set policy, identify opportunities, and define objectives;
- Decide amongst competing priorities for public resources;
- Ensure transparency and probity in the procurement process;
- Identify needs in terms of output specifications that encourage flexibility and innovation in the manner of performance;
- Set and ensure the achievement of standards;
- Establish, monitor and enforce the levels of service;
- Ensure value for money is achieved;
- Determine and manage reward mechanisms and tariff structures;
- Identify and propose the allocation of risks;
- Provide a clear regulatory framework and perform regulatory functions; and
- Safeguard the interests of customers and the general public.
Role of the Private Parties

- Achieve defined levels of performance in service delivery;
- Provide expertise and innovation;
- Provide access to private financing, as appropriate; and
- Provide a sufficient return to investors and other stakeholders.
- Do not take the responsibility of risks which cannot be managed by the private sector
- Understand the contractual terms comprehensively as the government contracts are rigid.
PPP is Now Omnipresent In Various Sectors

- Power
- Water
- Hospitals
- Schools (Grants in Aid)
- Stadiums
- Airports
- Information Technology
- Housing
- Roads
- Tourism
- Ports
- Citizen interface
Diagnostics for a PPP
(Issues needing attention)

- Technical
- Institutional and Capacity status
- Legal, Regulatory and Policy issues
- Commercial, Financial and economic issues
Technical Issues

- Present delivery system
- Proposed delivery model
- Defining and documenting the desired outcomes
- Identifying differentiating factors in each of the components of a project
- Procurement plan for each of the components
- Defining the metrics for performance measurement

Experiencing Technical Difficulties
Legal Regulatory and Policy Frameworks

- Understanding of regulatory bodies, regulations;
- Major sector institutions and government entities related to the sector;
- User charges and subsidy policies and arrangements;
- Existence and applicability of legally mandated service quality standards;
- Environmental and health regulations;
- Relevant labor laws and regulations
- Arbitration frame works
- Audit of performance standards and service level agreements
Institutional Structures And Capacity

- Institutional and legislative frameworks to support the business model
- Capacity to match the role and responsibilities of stakeholders
- Institutional structure to delegate the responsibilities to private sector
- Alignment of risk and reward with the ability to manage the risk by a stakeholder
- Capacity to monitor the performance and service level agreements
Commercial, Financial and Economic issues

- **COMMERCIAL**
  - Suitability of the business model
  - Funding arrangements
  - Win-win strategy
  - Commercial viability to the private sector

- **FINANCIAL**
  - Design of realistic pricing of user charges
  - Social responsibility of the government
  - Need for subsidy and viability gap funding
  - Business case analysis

- **ECONOMIC**
  - Cost–benefit analysis
  - Benefits analysis in qualitative terms
PPP: Basic Options

- Service Contracts
- Management Contracts
- Lease Contracts
- BOO/BOOT
- Concessions
- Joint Ventures
Services Contracts

**Similar to the Outsourcing model**

- Government maintains complete control on the project creation, execution and assets
- Government funds the project investments for the capital and operational expenditure during the project tenure
- Government leverages private sector strengths for creation of the project or maintenance of the project or both
- Risks are allocated to the government and private sector based on the responsibilities (e.g. government will have the risk of project demand, the private sector will carry the risk of performance and quality of the services delivered to the government)
- Does not attract capital investment
- No deeper impact on the services delivery
Management Contracts

- Similar to the Outsourcing model
- Contractual arrangement for the management of a part or whole of a public enterprise by the private sector
- Allows private sector skills to be brought into service design and delivery, operational control, labour management and equipment procurement.
- Public sector retains the ownership of facility and equipment.
- The private sector is provided specified responsibilities concerning a service and is generally not asked to assume commercial risk.
- The private contractor is paid a fee to manage and operate services.
- Normally, payment of such fees is performance-based.
- But longer period may be used for large and complex operational facilities such as a port or airport.
**Lease Contracts**

- Assets are owned by the public sector
- Operator takes lease of both infrastructure and equipment from the government for an agreed period of time
- Government maintains the responsibility for investment and thus bears investment risks
- The operational risks are transferred to the operator
- Fixed facilities and land are leased out for a longer period than for mobile assets.
- Private sector is responsible for the service delivery
- Under a lease, the operator retains revenue collected from customers/users of the facility and makes a specified lease fee payment to the contracting authority
## Comparison of the PPP options (Illustrative)

<table>
<thead>
<tr>
<th>OPTION</th>
<th>ASSET OWNERSHIP</th>
<th>OPERATIONS &amp; MAINTENANCE</th>
<th>CAPITAL INVESTMENT</th>
<th>COMMERCIAL RISK</th>
<th>CONTRACT DURATION</th>
<th>COMPENSATION TERMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>SERVICE CONTRACT</td>
<td>Public</td>
<td>Public &amp; Private</td>
<td>Public</td>
<td>Public</td>
<td>1-2 years</td>
<td>Unit prices</td>
</tr>
<tr>
<td>MANAGEMENT CONTRACT</td>
<td>Public</td>
<td>Private</td>
<td>Public</td>
<td>Public</td>
<td>3-5 years</td>
<td>Fixed fee liked to SLAs</td>
</tr>
<tr>
<td>LEASE</td>
<td>Public</td>
<td>Private</td>
<td>Public</td>
<td>Shared</td>
<td>8-15 years</td>
<td>Fixed/Sharing of Revenues</td>
</tr>
<tr>
<td>CONCESSION</td>
<td>Public</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>Varies on the project: generally long term</td>
<td>All or part of user charges</td>
</tr>
<tr>
<td>BOT/BOO</td>
<td>Private/Public</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>Varies on the project</td>
<td>All or part of user charges</td>
</tr>
<tr>
<td>JOINT VENTURE</td>
<td>Private/Public</td>
<td>Public &amp; Private</td>
<td>Public &amp; Private</td>
<td>Private</td>
<td>Indefinite</td>
<td>Revenue sharing</td>
</tr>
</tbody>
</table>

PUBLIC

PRIVATE

PUBLIC/PRIVATE