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## ABOUT THE AUTHORS

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# SmartLessons

*real experiences, real development*

## A Winning Framework for Public-Private Partnerships: Lessons from 60-Plus IFC Projects

*Despite global financial uncertainty and increased public mistrust of business, partnerships between the public and private sectors have continued to grow—driven by governments' need to access external financing and expertise, by the private sector's search for new opportunities, and by governments' desire to grow the private sector. This SmartLesson addresses the critical question: How can the public and private sectors build successful partnerships?*

### Background

For public and private sector leaders and managers contemplating partnership for the first time, public-private partnerships (PPPs) can appear to be political and economic minefields, filled with technical complexities best left to experts. Furthermore, the sheer volume of advice and information on PPPs is intimidating and unwieldy, with a simple Google search of the term "public private partnership" yielding over 20 million hits.

In the midst of this wealth of detailed information we saw a gap: We believe that senior leaders in the private and public sectors could benefit from an overall framework for creating successful partnerships between the public and private sectors. The framework should be simple and based on real experience, and it should give leaders a comprehensive "checklist" to help them navigate the wealth of critical issues, information, and advice on PPPs. By reviewing the extensive experience within IFC we have developed just such a framework.

IFC is a member of the World Bank Group, whose overall aim is to reduce poverty by providing economic and technical assistance to developing nations. Within IFC, we work in the Public Private Partnership Advisory Unit, which has advised governments on structuring and bidding out PPP transactions for over two decades. Although we work with developing countries, we believe

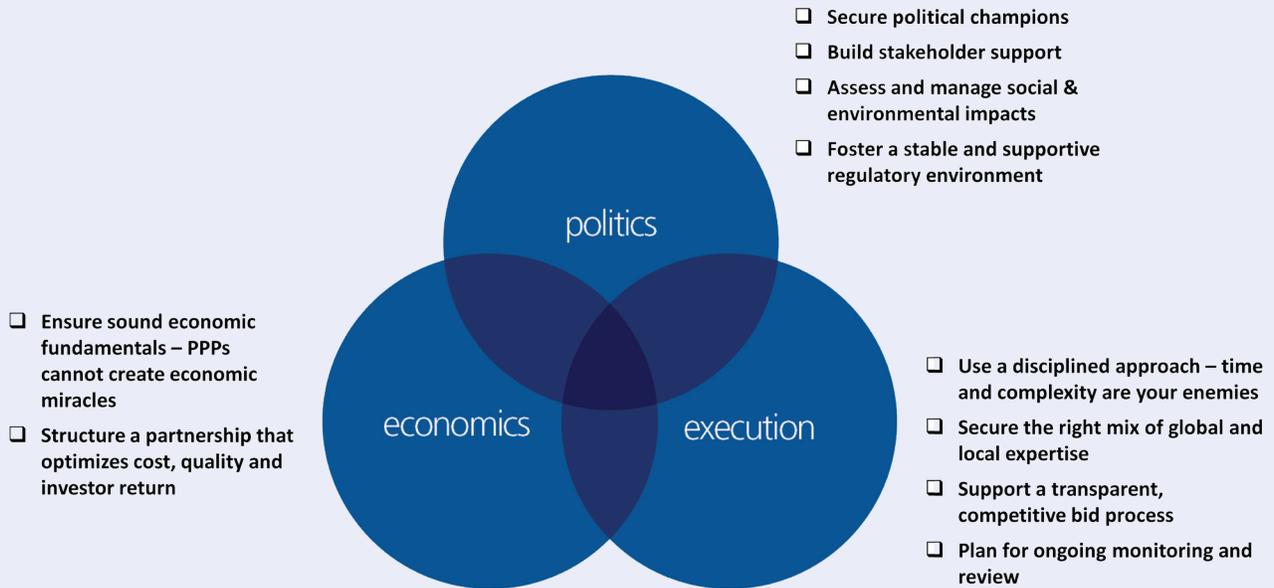
that our experience applies equally well in developed countries.

To define and test the framework, we reviewed the projects in our unit over the past seven years, consisting of more than 60 PPPs in over 35 developing countries, representing approximately \$10 billion in investment, and delivering improved services to more than 30 million people. The defining feature of all these projects is a long-term partnership between the public and private sectors to deliver a public service, with some transfer of risk to the private partner.

Ranging from hospitals in Africa to toll roads in South America to hydroelectric projects in Europe, and including both successful and failed projects, our case experience offers a rich and diverse array of lessons for anyone contemplating partnership between the public and private sectors. In fact, at the end of each project, IFC teams identified a handful of "lessons learned," which we compiled into a database of over 350 lessons and then systematically analyzed. Review of other IFC projects further shaped our thinking.

Our research shows that the lessons fall into three broad categories: economics, politics, and execution. Indeed these categories represent the three fundamental forces that drive the success or failure of PPPs. Economics, politics, and execution are the spheres of activity that leaders must understand and manage if the projects are to be successful. (See Figure 1.)

Figure 1: Framework for Building Successful PPPs



An understanding of these forces is the product of a wealth of wisdom from our project teams, hard-earned and grounded in real case experience over the past seven years. From this experience we have identified specific lessons within each of these spheres.

**LESSONS LEARNED**

**Economics**

**1) Ensure sound economic fundamentals.**

Governments sometimes see PPPs as a way to rescue financially challenging projects. While PPPs can indeed improve project economics, basic economic assumptions such as revenues, costs, and level of investment must integrate into a reasonable and sustainable business case. An example is a successful African water project where the customers’ ability to pay was the critical issue. It determined cash flow and the amount of debt, driving the overall size and success of the project. In contrast, a European toll-road project died when political leaders insisted that two extra lanes be added, and the subsidy required would have been enormous. PPPs can deliver successful and financially attractive projects—but they can’t perform economic miracles.

**2) Structure the partnership to optimize cost, quality, and investor return—in other words, to achieve both the public policy and business objectives.**

There are many partnership options to choose from, ranging from conventional procurement of goods and services to management contracts, through to full private ownership. The challenge is defining a partnership that meets the public policy goals while creating or strengthening a successful, sustainable business. Defining the right partnership requires knowledge of similar past transactions, understanding of the local market, and innovation. One example is an electricity project in a recently war-torn developing state.

Given the poor condition of the infrastructure and the economic risks, attracting or establishing a fully private utility was not a feasible option. So a management contract, with both incentive and penalty payments, was negotiated with an international operator to oversee the existing utility. The project has resulted in improvements in both service and financial performance—meeting the public policy objectives while improving the business.

**Politics**

**3) Secure political champions.**

Any project requires a champion: someone to articulate and refine the vision, guide progress, and advocate for support. For PPPs, political champions are particularly vital, given the significant public stake in them. Our teams repeatedly cite the importance of political champions, and it is rare for major projects to survive without them. This is most evident in high-profile or publicly sensitive sectors such as airlines, where carriers are often viewed as national treasures. In airline transactions in Asia, Africa, the Caribbean, and elsewhere, we have found waxing or waning political support to be the difference between project success and failure. A strong champion or multiple champions can make all the difference, as in a recent successful hospital project in Africa, where the team cited the strong support of both the minister of finance and the minister of health as a key reason for the project’s success.

**4) Build stakeholder support.**

PPPs typically feature a large assortment of interested and influential stakeholders, with diverse economic, political, social, and environmental concerns. Indeed, the majority of our projects cite stakeholder support as a critical element to project success or failure. But the most successful projects and leaders do more than just identify and manage stakeholders; they also develop a deep understanding of stakeholders’ interests and optimize the business case accordingly. Two water projects in Asia illustrate this

lesson vividly. Water is a particularly sensitive sector, and many water projects fail—not because of economics, but because of social, political, and environmental concerns. In one country, a key feature of the project was a legal requirement that the private partner be 60 percent locally owned. The project moved forward successfully and is now yielding fresh water, with better service and lower rates to residents. In a second country, a lack of local investors contributed to public unease, which was a key driver of the project’s ultimate failure and termination.

### **5) Assess and manage the key social and environmental impacts.**

Attention to social and environmental issues is a precondition for success, and at IFC this has become one of the first things we consider in accepting or rejecting a project. Addressing social and environmental issues is not just the right thing to do; it is also good business, with major projects unraveling when these issues are not fully considered. An example is a European hydroelectric project that was shelved because of specific concerns regarding water levels. Through a technical redesign, the team was able to solve these issues, and the project was restarted and successfully completed.

### **6) Foster a stable and supportive regulatory environment.**

A sound regulatory environment is often a condition for the success of a PPP. This is particularly true in sectors where fundamental elements of the business case—such as prices—are driven by regulation, and a stroke of the pen can create or destroy a business. In Southeast Asia, a program to foster private sector participation in rural electricity production focused first on establishing a supportive regulatory environment, including clear guidelines for subsidies. The program has resulted in lower cost and increased access and reliability, and it has stabilized the previously unpredictable, large, and unsustainable subsidies required for this service.

## **Execution**

### **7) Use a disciplined approach—time and complexity are your enemies.**

A disciplined approach to project management is valuable in any project. But it is particularly important in PPPs, where transactions can be complex and timing is often critical because of limited political windows. An example is a failed power generation project in South Asia, where a project was terminated when a new government was elected. Overall, our experience suggests that the longer a project takes, the less likely it is to succeed. We recommend clear project timelines and accountabilities as well as strong orchestration of external advisors.

### **8) Secure a mix of global and local expertise.**

The quality of teams is particularly important given the potential technical, economic, and political complexities inherent in PPPs, and having the right balance of global and local expertise is critical. Global experts can bring critical knowledge and best practices from other sectors or geographies—expertise that is not easily obtained elsewhere. Yet perhaps even more important is the presence of local, on-the-ground capabilities. Again and again, IFC project teams note the importance of both global and local expertise and presence. An example is a desalination project in the Middle East, which cited the combined expertise of its global and local technical consultants as one of a handful of key drivers of the project’s success.

### **9) Support a transparent, competitive bid process.**

Unsolicited bids and noncompetitive processes are often tempting—either for governments wanting to move quickly or for companies looking to gain an advantage. For large PPP contracts, we strongly recommend transparent, competitive bid processes. Not only is it good business practice, but also anything less risks undermining long-term

## **Box 1: Questions to Reveal Red Flags**

### **Economics**

- Are the basic economics of the project strong (that is, does it have a good economic rate of return)?
- Does the project have small fiscal implications compared to the government budget (or, better, would it be a net fiscal contributor)?
- Is the government, or off-taker, seen as creditworthy by investors? Or could insurance or guarantees effectively compensate for poor creditworthiness?

### **Politics**

- Is there both top-level political support (president, minister of finance) and support from the relevant line ministries?
- Is the project supported (or at least not opposed) by a broad spectrum of the key stakeholders (politicians, unions, companies, consumers, nongovernmental organizations)? Has adequate and meaningful consultation been undertaken?

- Can the project proceed now without further approvals from the country’s Parliament or other legislative body?
- Is the current government expected to be in power for more than a further 12–15 months?
- Has the country been free of high-profile nationalizations (direct or through regulation) in the past five years?

### **Execution**

- Has adequate preparatory work been done (for example, an economic and social feasibility study, land acquisition, and so on)?
- Is the project part of a larger program of PPPs?
- Is there a single government entity responsible for implementing PPPs, and does that entity have a track record of successful execution?
- Have reputable transaction advisors been retained?

public support of the partnership. In one Asian country, the government had been heavily criticized for moving too quickly on a previous airport privatization. On a subsequent waste management project the project team paid particular attention to a fair and transparent bid process, citing this as a critical element in the project's success. There are circumstances where sole-bidder negotiations can be advantageous to governments, but these are exceptions to be managed with care.

#### **10) Plan for ongoing contract monitoring and review.**

Partners need to have the capacity to monitor and manage their contracts, ensuring compliance and resolving disputes. They also need to contemplate the possibility of renegotiation as the situation changes over the years. The need to renegotiate is not necessarily a sign of failure; it also can result from projects that are overly successful. An example is a successful Latin American hospital project, where improvements to services increased the demand beyond the original business case, encouraging the government and the private partner to revisit the level of subsidy. For governments, the capacity established for PPP monitoring and review can also provide a base of expertise for undertaking further PPP projects.

#### **Putting the framework into action**

Whether you are in the public or private sector, these hard-won lessons provide a practical framework for building successful public-private partnerships. Use it as an overall guide to the types of issues and tasks you must pay attention to.

You may find, as some of our teams have reported, a natural tendency to focus on the one or two spheres within the framework that you are most comfortable with and have the most control over. Avoid this tendency by assessing your efforts against the framework—to identify areas you may have overlooked.

Policymakers and investors should watch for “red flags” in each of the three spheres, indicating areas to focus on. Box 1 suggests 12 questions that government policymakers or investors might ask, with a “no” response indicating a red flag.

Perfect answers are not required for every question. For example, we had a *European health-care* project where the health minister and project champion changed five times. Despite these political weaknesses, the project nevertheless succeeded because of its strength in other dimensions. However, while two or three red flags may not be a deal killer, if over half of the questions in Box 1 are answered with a “no,” then it might be worth reexamining whether undertaking a PPP at that time would be appropriate.

Ultimately, the challenge for leaders is to deeply understand and address the three spheres—economics, politics, and execution—in an integrated way. Chief executive officers need to understand that political issues and stakeholder interests are just as important to a politician as shareholder value is to a chief executive officer. Political leaders, for their part, need to understand that chief executive officers and PPPs can't create economic miracles. With this understanding, true partnerships will grow and flourish.



#### **DISCLAIMER**

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