

5 Structuring a PPP: Selecting the Option

As previously mentioned, PPP should be implemented within an overall reform strategy. The objectives of a PPP project will be a subset of the objectives for the overall sector reform. Selecting an appropriate PPP option is based on a diagnosis of:

- PPP options available (as described in chapter 4),
- technical constraints and goals of the sector (as identified in the diagnostic),
- legal and regulatory constraints (as identified in the diagnostic),
- institutional issues (as identified in the diagnostic),
- commercial, financial, and financing requirements and constraints (as identified in the diagnostic),
- interest of the market (local and international as described below), and
- special requirements of the sector based on characteristics of the system or population.

The list of reform objectives should be compared with the results of the diagnostic and features of each contract type, its advantages and disadvantages, likely outcomes and prerequisites. From this analysis, it is possible to determine which option is most likely to succeed at meeting the greatest number of (or the most critical) objectives.

Priorities for a PPP might include increased coverage, improved services, efficiency improvements with associated reduction in government subsidy, or customer satisfaction. The government and its advisors would use cost/benefit analysis and would consult with a wide range of possible private partners (operator survey) to gain insight on the appeal, or lack of appeal, of the options under consideration.

Particular PPP forms are used more widely and are more readily applied to particular sectors. For instance, BOTs are more often employed in the development of toll roads and wastewater plants while management contracts might be seen in health-care or water services.

That said, no PPP option could be applied without tailoring it to the local context. The options provide a menu of contract types that can be modified to suit specific project requirements. Incorporating different components of different contract types or using several contracts in combination may be necessary. Additional modifications may be necessary to facilitate the financing of the transaction, to respond to concerns of potential partners, to improve low-income service provision, and to address labor issues.

Government objectives for the PPP process: Selecting a PPP option is influenced by the government’s specific objectives. For instance, is it government’s priority to reduce the costs of service? On the other hand, is there a limited goal to improve billing and collection? Or is the priority to expand coverage? Depending on the objectives, different options may be more suitable to delivering them in a project.

Prerequisites to implementing a particular form of PPP: The diagnostic analysis determines the status of the sector undergoing reform. Each form of PPP has a set of prerequisites for successful implementation. For instance, deeper forms of PPP that transfer greater risk to the private sector will require more sophisticated legal and regulatory structures, as well as availability of local skills to implement and monitor the transactions. Other constraints may be low-cost recovery levels, lack of system information, or poor technical performance. If prerequisites are not in place as determined through the diagnostic, it may be prudent to start with a less extensive form of PPP. An alternative would be to achieve PPP prerequisites, see Table 6, during the preparatory phase by implementing legal and regulatory reforms, ensuring key investments are made, and/or putting new institutions in place.

Table 6: Prerequisites of PPP Options

Option	Political Commitment	Cost Recovery Tariffs	Regulatory Framework	Information Base	Government Capacity for Contracting, Management, and Analysis
Service Contract	Low	Low	Low	Low	Moderate
Management Contract	Moderate	Moderate	Moderate	Low	Moderate
Lease	Moderate	High	High	High	High
Concession	High	High	High	High	High
Build-Operate-Transfer and variations	High	Variable	High	High	High

Source: Heather Skilling and Kathleen Booth. 2007.

The private sector’s interest in the option: A particular option such as a concession may best meet the objectives of the government, but the level of risk may be unacceptable to potential private investors. The likely level of interest can be assessed through analysis of previous investments in the region, country, and sector, and by assessing the market interest.

Before the formal procurement process, potential bidders are often invited to comment on a proposed project structure. The comments are based on a pre-bid road show, a briefing, or a project paper, which is shared. Often, the opportunity is described in an “Information Memorandum”, a summary of the key attributes of the project, the operating environment,

and anticipated financing. These discussions also generate market interest in an opportunity and may broaden the pool of potential bidders. Collecting this market feedback from potential private partners during the design/preparatory phases ensures that the bid package attracts interest.

Based on these three criteria, the available options can be ranked and the government can take an informed decision on the PPP strategy to be adopted. The road map will then be updated to reflect the PPP option selected and preparatory work can start.