

## Public-private partnership project success circumstances

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**Abstract:** The public-private partnership has been in use in the world for over 40 years, and has been growing at a varying rate and with mixed success in different countries. Based on the experience gained in selected countries, this article shows key success factors of the public-private partnership.

**Key words:** public-private partnership; legal regulations; risk distribution; venture profitability

### 1. Introduction

The public-private partnership (PPP) is based on cooperation of a public entity with private entities aimed at mutual benefits. The PPP is particularly attractive in those instances where on the one hand, there is strong demand for rendering services (communication infrastructure, water supply, wastewater disposal and treatment, waste management, public transport, construction of cultural facilities, public administration buildings, hospitals, schools and even prisons) and on the other, a lack of sufficient, own capital to realize costly investments or to modernize inefficient infrastructure. A public-private partnership agreement is a binding legal act which remains in force until the expiration or termination of such a partnership. In accordance with Article 16 of the Public-Private Partnership Act<sup>1</sup>, the decision to conclude a partnership agreement is at the public entity's discretion and such an agreement is concluded for a period of more than 3 years. The public-private partnership is a special case of a public procurement order, because it entrusts delivery (together with the necessary infrastructure) of public interest services in exchange for compensation paid from public funds. Preparation of the agreement is preceded by a comparative analysis, which determines the cost of risk, savings that should result from the investment realized with the PPP method and some other information that can affect the framework of the agreement.

Analyzing aspects of the public-private partnership's success, it is worth looking at the current state of this phenomenon and its past development. Table 1 and Figure 1 present the value of the public-private partnership projects fully completed<sup>2</sup> in the years 1995-2004 in the selected regions.

The data presented above indicates a stable level of investment in projects with the participation of a private partner, especially in Europe and Central Asia. At the same time, looking at the period 1995-1998, one can observe an investment boom in this field in the majority of the presented regions, particularly in Latin America. This, however, shows that public-private partnership had already been well established in most of the countries, as one of the methods for financing infrastructure investments.

Based on the selected examples of implementing private-public partnership projects in the world, we can try to determine certain key factors for the success of such projects. The factors listed below must be of a universal character and must be appropriate for application in every market field (industry) where public investments are realized.

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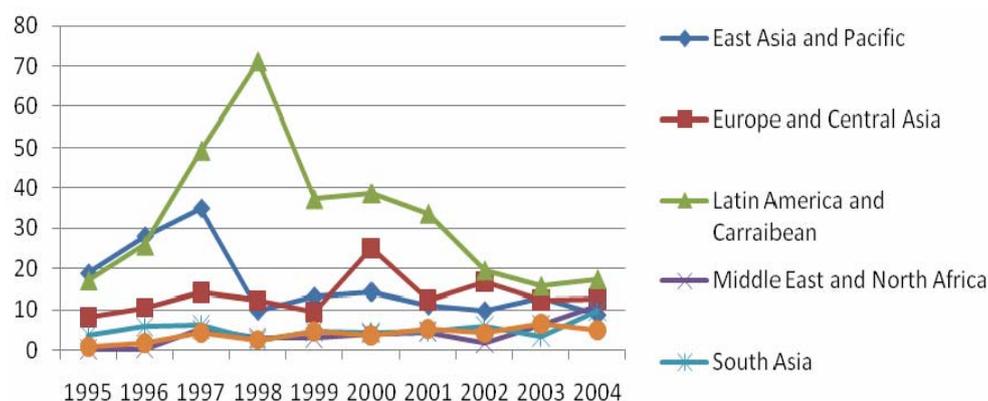
<sup>1</sup> Polish Private-Public Partnership Act of 28<sup>th</sup> July, 2005, J. L. no. 169, item 1420, as amended.

<sup>2</sup> "Fully completed" according to the author means fulfilment of all procedural procedures and organizational processes of contracting within the public-private partnership, including access to project financing.

**Table 1 Investments in infrastructure projects involving a private partner in the developing countries**  
(in billions of U.S. dollars)

Region	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
East Asia and the Pacific	18.8	28	34.9	9.7	13.1	14.3	11	97	13	8.7
Europe and Central Asia	8.1	10.5	14.2	12.1	9.4	25	12.3	16.8	12.2	12.5
Latin America and the Carraibbean	17.1	25.8	49.3	71.2	37.3	38.7	33.7	19.6	15.8	17.4
Middle East and North Africa	0.1	0.3	5.1	3.1	3	4.1	4.4	1.6	6.2	10.9
South Asia	3.8	5.8	6.3	2.3	4.6	4.4	4.6	6	3.4	9.6
Africa (Sahara Region)	0.8	1.7	4.3	2.5	4.6	3.7	5.3	4.2	6.5	4.9
Total	48.7	72.1	114.1	100.9	72	90.2	71.3	57.8	57	64.1

Source: Izaguirre, Ada Karina (2005).



**Figure 1 Investments in infrastructure projects involving a private partner in the developing countries**  
(in billions of U.S. dollars)

Source: Own interpretation based upon Table 1.

## 2. Clear financing structure as the PPP's success factor

The planned venture which is to be realized in the form of a public-private partnership must be financially feasible. The project's long-term term structure, from the point of view of the bank as the financing organization, is ever more frequently seen as a safe transaction<sup>3</sup>. In the majority of cases the financial structure of this type of project anticipates a significant involvement of external financing capital. A special purpose vehicle (SPV)/company is established under the PPP project, that is a company that receives the material assets contributed (contribution in kind) by the public partner in exchange for the company shares. Such contributions usually improve and ensure a good financial position of the SPV so as to obtain a positive credit ability assessment from the financing institutions. It is also strengthened by the capital contributions made to the company by the private partner as well as by the guarantees securing the repayment of the debt to the financing institution. Such guarantees, in most of the cases, are not only secured with the SPV's assets but also with the guarantees and suretyships from the public sector partner. Also, the contractual guarantees are important, guarantees which are given by the public payer in the form of guarantees for financing a long-term debt of a public nature, which are provided by the SPV as part of the public-private partnership. The above mentioned selected factors which are intended to secure the project's financial profitability should be included in a detailed,

<sup>3</sup> "Korzyści i ryzyka Partnerstwa Publiczno Prywatnego w percepcji instytucji finansujących" materials of WestLB Polska SA, 2004.

feasibility study for the project in the form of a PPP<sup>4</sup>. Such a study must demonstrate the financial and economic viability of the undertaking, taking into account the different scenarios for the project's implementation<sup>5</sup>. As can be observed in the selected countries, there is a tendency to increase the PPP projects' profitability, to engage private capital for the entire duration of the project, and wherever possible, to create hybrid financing structures combining the investor's private capital, financing institution's capital, public capital and public funds including those of the EU, the European Investment Bank and the World Bank. An example of complications in a PPP project due to errors in the feasibility study, taking into account different scenarios for the investment implementation, is the Guangzhou-Zhuhai expressway in China. It was one of the first road projects in China carried out with the significant participation of a private partner. It started during the economic boom in China in the period of loose economic restrictions on the possible participation of foreign investment capital in infrastructure projects. As a result of the expressway, the travelling time between Guangzhou and Hong Kong was meant to be reduced from 6 hours to 75 minutes<sup>6</sup>. The project proved not to be feasible from the start. The main obstacles resulted from the huge underestimation of the construction costs (necessary rebuilding and the costs of acquiring additional land for construction), the lack of sufficient investment scenarios for the investment implementation, which could have included the option to cover the additional financial needs. As a result, instead of two entities which had initially been planned as the basis for financing of the project, the final financing structure comprised shareholders' capital, loans from shareholders, a loan granted by a consortium of 34 commercial banks, and a bond issue.

### 3. Clear legal framework as a prerequisite for PPP success

Another factor contributing to the success of the public-private partnership is a clear and stable legal framework for that type of investment (Brzozowska, 2006). In some countries, no laws directly regulating investments realized under a PPP, have so far been established; these include: India, France and the United Kingdom. In other countries however, clear and strictly binding legal regulations have been introduced for the implementation of the PPP; these include: Poland, Mauritius and Spain. However, it seems that it is not the existence of special legislative acts which provides chances for the success of a project, but only the skilful use and co-existence of legal norms that clearly identify which entities are authorized to realize investments as part the PPP, and which govern the situation of investors and financial institutions in those projects. The acts governing company law, tax law, collateral law, foreign investment law, intellectual property law and public finance law must prove to be favourable. One example of the importance of legal regulations to the success of PPP projects is Poland, which is one of the few EU countries that has decided to introduce legal regulation of PPPs. The adopted act on public-private partnership and three adopted<sup>7</sup> regulations have defined the circumstances for the

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<sup>4</sup> Successes and failures for PPP Project, The World Bank Europe and Asia Region, 17 June, 2008, Warszawa. unpublicized, conference materials.

<sup>5</sup> BOT w projektach partnerstwa publiczno-prywatnego, UNIDO BOT Guidelines Diffin, UNIDO, Bank Gospodarstwa Krajowego, Warszawa 2006, p.253.

<sup>6</sup> Project finance systems in toll road project in Asia, K.A.K. Devapriya, S.Gentz, H.W. Alfen, Knowledge Center Weimar, Bauhaus Universitat Weimar, 2004. International Symposium on GLOBALISATION and CONSTRUCTION. Proceedings. CIB W107 and CIB TG23-Joint Symposium.

<sup>7</sup> Ordinance of the Minister of Finance, of June 30, 2006 on necessary elements of venture analysis as part of a public-private partnership, J.L. no.125 of July 13, 2006, item 866; Ordinance of the Minister of Economy, of June 9, 2006 on detailed scope, forms and rules for preparing information regarding public-private partnership agreements, J.L no.125 of July 13, 2006, item 867; Ordinance of the Minister of Economy, of June 21, 2006 on risks associated with implementation of ventures as part of a public-private partnership, J.L. no.125 of July 13, 2006, item 868.

application of a PPP, the preparation of joint implementation of the investment and the rules and mode of selection of the private partner. Despite rather precise regulation, no PPP project has been implemented so far under the Public-Private Partnership Act of 2005 in Poland. The reasons for this can be associated with:

(1) A wrong assumption that a PPP should be used only if it is more favourable than other options of project implementation;

(2) A far-reaching formalism at the pre-decision stage, which precedes the project implementation in the form of a PPP, which imposes on the public entity the obligation to carry out numerous analyses, including economic and financial ones of questionable usefulness;

(3) An excessive, compound reporting obligation during the implementation of the PPP.

The Public-Private Partnership Act of 2005 did not contribute to the popularization of the public-private partnership in Poland, and was not a panacea for the rapid development of infrastructure investments. Its fundamental weakness was the highly complicated procedures at the stage preceding making the decision to implement projects in accordance with the PPP framework. A public entity is expected to perform a series of comparative analyses (economic and financial, legal, asset related and risk distribution analyses), the result of which must show that a PPP is a more favourable method than other, traditional methods. Carrying out of the analysis has turned out to be highly complicated and time consuming. In the majority of cases the performance of those analyses would entail subcontracting them to external entities. Paradoxically, the PPP had been easier to implement before the Act of 2005 was adopted and came into force. At that time, the possibility of implementing an investment as part of a PPP resulted from the freedom of contract<sup>8</sup>. The framework of the PPP regulation of 2005 seemed to indicate that the legislator created theoretical chances to use the PPP for the implementation of public sector investments. On the one hand, a legal regulation was introduced for the institution of the PPP, suggesting that it should be widely used, while on the other hand, it was defined in such a way that made it extremely difficult to use in practice, which has resulted in it remaining dead/unused<sup>10</sup>. The changes introduced through the amendment to the Public-Private Partnership Act, generally, should be perceived as positive. They have contributed to a reduced formalization of the PPP as a way of fulfilling public tasks. The basic barrier for the broad application of the PPP was eliminated, which was the erroneous assumption that public sector entities may use this method (PPP) of fulfilling public tasks only when it is more beneficial than the other, traditional methods. The obligation to carry out analyses at the pre-decision stage by a public entity in order to implement the tasks based on the PPP terms was removed. Now the public sector entities will not be required to prepare reports on the implementation of a PPP or to transfer them to central government authorities. It can therefore be concluded that for the stable development of public-private partnerships, the permanent legal regulations are beneficial, which clearly show the ways and the options of mutual connections between public and private entities, irrespective of whether those regulations constitute one, coherent legal act or whether the cooperation is based on the skilful use of a wide range of legal regulations of a particular country.

#### **4. Transparent distribution of risk in the PPP as a means for PPP project success**

Another factor for the success of the PPP is the proper distribution of project risk and risk management throughout the duration of the project. In the public sector, risk management development occurred later than in the private sector. It is believed that the risk management programs worked out by public entities are a relatively

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<sup>8</sup> The Polish Civil Code Act of April 23, 1964, J.L. item 93, as amended, art. 3531.

new development (Williams, Smith & Young, 2002). This results from the more cautious introduction of any innovation in public sector financial management, including financial management of a public entity as a whole, or in its various organizational forms. It should be noted that the observation and analysis of the public partner's environment with regards to risk often depends on the individual perception of factors and on the experience of the public entity's employees (Filipiak, 2003). Moreover, in many fields of its operations, the public entity's employees are exempted from civil liability for their decisions, and in practice they have no such liability at all, because there are no laws which would expressly and unambiguously sanction the issues of decision making by public sector employees and force them to bear liability in the case of unfavourable consequences resulting from the decisions made. As a result of globalization and ongoing integration of the EU, one should expect an increase in the importance of risk management processes in the public sector and the emergence of risk existence awareness as well as of the responsibility being put on local governments as on those who provide contribution to the benefit of local/regional communities. Therefore, professional risk analyses and risk management programs appear to be a key element for the success of long-term investment projects under PPP circumstances. Managing various risk areas is done through:

(1) Identification of the main risks (risk areas);

(2) Determination of which side (public or private) will bear the burden of the identified risks, which is associated with costs and the degree of control of those risks;

(3) Conclusion of appropriate contracts, agreements, financial obligations providing full security against potential risk;

(4) Preparation of action scenarios, including the impact of materialization of the risk on the implementation timetable and the financing plan of the PPP project.

**Table 2 Short risk distribution scheme in the PPP project of an expressway in the Philippines**

Risk	Private partner	Public partner
Technical/design	<input type="checkbox"/>	
Construction	<input type="checkbox"/>	
Operational	<input type="checkbox"/>	
Market/demand	<input type="checkbox"/>	
Budget	<input type="checkbox"/>	
Political/Regulatory		<input type="checkbox"/>
Forces of nature		<input type="checkbox"/>
currency	<input type="checkbox"/>	
Environmental	<input type="checkbox"/>	

Source: [http://www.unescap.org/ttdw/common/TIS/AH/files/Investment\\_Forum2007](http://www.unescap.org/ttdw/common/TIS/AH/files/Investment_Forum2007).

Note: : risk distribution.

An exemplary, short table showing the risk distribution between the partners in the project of constructing a road transportation route in the Philippines is presented in Table 2. The criterion for the allocation of risk between the partners in this project was the determination of which of those two project participants is better suited to provide security for the identified, particular risk area. Also, a special purpose vehicle (SPV) was established under the name of Tall Regulatory Board, whose shares, in addition to the private partner, were purchased by government agencies, including public institutions responsible for transport. The North Luzon Expressway was designed as an expressway of a total length of 335 km. For the management and maintenance of the road, a

consortium of entities involved in the financing of the project was established, which included corporations from France, Australia and the Philippines. The project's expected duration is 30 years. After that period, the infrastructure is supposed to be transferred back to the public sector side without any financial claims.

In particular, the scope of responsibilities of the public partner includes: organization of all permits, licenses to build and maintain the road, approving the amount of the toll collected for using the road, the obligation to compensate the private partner in the case of project termination due to a fault not attributable to the managing consortium. On the consortium's side, there are the following obligations: organizing and securing necessary financing, infrastructure management for the entire duration of the project, maintaining the infrastructure's expected quality, optimizing the financial management of the consortium, the obligation to transfer the infrastructure back to the public sector after 30 years of the project duration. The presented way of risk distribution is not the only possible way. In every PPP project, the risk allocation may be different, and it will depend on the risk management capabilities of each of the entities as well as on the appropriate translation of costs associated with the risk accepted by the entity into legal provisions included in the PPP agreement, and on the ability to cover them with the planned cash flows of the project. The risk distribution should also be directly related to the planned project timetable and to the cash flow plan. Coherent matrixes in those areas allow effective risk management of the PPP project.

## 5. Conclusion

Summarizing the analysis of key factors for the success of public-private partnerships (PPP) one should stress that it depends on the creation of proper rules of cooperation (partnership), where each side relinquishes part of its competence, rights and profits, as well as on actions aimed at working out a common objective. The essence of financial engineering, adequate risk distribution and a stable legal basis has been presented here as key factors for the success of public-private partnership in each region.

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