

Starting a Pro-Poor Public Private Partnership For a Basic Urban Service

Using This Guideline

Pro-poor Public Private Partnerships (PPPs) can supply better basic services (e.g. drinking water, waste collection, sanitation, etc) to poor communities in cities and towns. PPPUE's first generation of Innovative Project Grants (IPGs) supported 3 national programmes and 11 projects to support pro-poor PPPs in 14 countries. A lot was learnt. These lessons are translated in this Guideline on how to start up a pro-poor PPP to deliver a basic urban service.

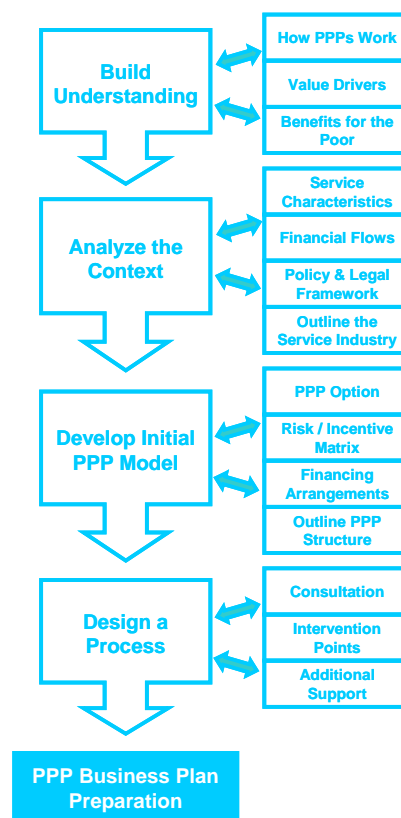
Successful PPP projects have a good understanding of PPPs from the beginning. The Guideline provides steps to make sure the main features of an effective pro-poor PPP are built in from the start. Do's and Don'ts are raised from the experience of what works well and what does not. Examples and cases of pro-poor PPPs in practice are also given. Examples are provided of PPP issues translated into contracts. Finally, information on where to get further support is provided.

Four basic steps are in the Guideline. **1. Build Understanding**: know and explain how PPPs work and potentially deliver value, especially for the poor. **2. Analyze the Context**: rapidly review the kind of service, financial flows, policy framework, and outline the service industry. **3. Develop Initial PPP Model**: explore PPP options, assess risks / incentives, consider financing, and outline a PPP structure. **4. Design a Process**: work out the consultation, intervention points and additional support needed to prepare a business plan for the PPP.

The Guideline can be used when:

- Preparing PPP projects for funding support (IPG and other sources).
- A request to support setting up a PPP to deliver a basic service is received.
- A local service delivery problem is encountered and a pro-poor PPP could be a solution.
- Developing national programmes to use PPPs for basic service provision.
- Generally promoting and facilitating the use of PPPs to deliver services to the urban poor.

The Guideline is intended for the main sponsors involved in promoting pro-poor PPPs. This includes UNDP Officers, local governments, local experts, potential private partners, Global Learning Network partners, and others.



1. Build Understanding

To set up an effective PPP the main sponsors must understand: **how PPPs work**, what are the **value drivers** in PPPs that make them offer better service, and especially **benefits for the poor**. This understanding should be developed among the main PPP sponsors.

How PPPs Work

PPPs can supply services well only if they are set up properly. It is very important to be clear about how they work. In a PPP, a private individual or company (large or small, formal or informal) supplies a service (e.g. waste collection, providing water). In return they are paid by the local government, or can collect money from the users of the service. Why is this more effective than the local government providing the service itself?

The **private partner** (including an individual) is a commercial enterprise and wants to profit. If the price cannot be raised and a minimum service

standard must be provided (two key ingredients discussed later), only **operational efficiency** creates profits. The private partner will **innovate** in the service design, choice of equipment, skills and organisation of staff, and operation and maintenance to meet service standards at the lowest cost possible. Daily the private partner will look for new and better ways of providing the

DO INVOLVE REAL PRIVATE PARTNERS

An individual or company (large or small, formal or informal) – that is motivated by commercial interests.

Make sure that the basic principles that make PPPs effective are understood and applied - the private partner must be motivated to perform; the public partner must oversee performance.

service (to try to increase profit). BUT, this only works if payment is linked to performance.

This is the role of the **public partner**. The public partner must **set service standards** (e.g. who should receive the service, what level of service, etc.) and **monitor performance** of the private provider to meet them. If inadequate, the private provider must face financial penalties – e.g. stopping payment, imposing a fine, taking away the right to collect user charges, replacing the provider. The public partner must also **regulate the price** of the service. Both performance monitoring and price regulation can be done either **directly** (e.g. the local government monitors performance and sets prices) or **indirectly** (e.g. the government makes sure performance and regulation systems are in place). An example of indirect regulation is where the local government makes sure that enough private providers compete to provide consumers the best service at the lowest price (market competition). But this cannot

DON'T LOSE COMMERCIAL INCENTIVES

Non-commercial organisations (e.g. NGOs, CBOs) are motivated by other objectives than profits, and do not respond to PPPs like private partners.

be done in all services. Where it makes sense to have only one provider (e.g. providing drinking water), the public partner must directly ensure the price of water is controlled. **Service recipients** should take part in performance monitoring and regulation. There must

be communication channels for feedback on actual service quality, quantity, price and so on. **Civil society bodies** (including community organisations) can play a watchdog role, and can also help to organise service recipients to effectively express their interests.

In these circumstances the private partner is motivated to provide a good service at the best price possible. The public partner monitors performance and protects the interests of consumers. In this situation the urban poor can benefit. These basic principles are why PPPs can supply services effectively. The principles apply to all kinds of PPPs, at all scales and levels of complexity.

PRACTICAL CASES

Nepal Brings Business to the Table

PPP sponsors in Nepal work closely with national and local business organisations. Through these organisations private companies understand PPPs and are interested in the opportunities. Pro-poor PPPs that have been identified in local cities are practical and interesting for small local companies to get involved in.

Defining Private Partners in Indonesia

Indonesian local governments believed PPPs were only for big companies, and only charity organisations were interested in helping poor areas. When considering pro-poor PPPs they ignored the many small & medium businesses that exist in poor areas in Indonesian cities. Neither big nor small companies were invited to initial PPP discussions and private sector perspectives on pro-poor PPPs were not known.

Defining Pro-Poor PPPs in Uganda

Many stakeholders in Uganda struggled to know what a pro-poor PPP was. Some saw it just as a process of community consultation and participation. Others saw pro-poor PPPs as partnerships between the public sector and communities. As a result the private sector (informal and formal) was not really involved.

NGO as a Private Partner in Malaysia

A PPP in Malaysia that attempted to collect recyclable waste from households through an NGO and using volunteers failed because the volunteers soon lost interest. The NGO did not have a strong idea of how to organise collection as a sustainable business. At the same time, however, several private recycling companies were doing excellent business collecting recyclables from the same areas.

Value Drivers

Why are PPPs valuable for consumers and the urban poor? PPPs are effective if the **incentives and risks** of the partners to perform are right.

The private partner's incentive must be to deliver a good service; the public partner's to regulate service delivery in the interests of consumers. Partners have incentives if they face **risks**. Risks in a PPP are the "What happens if ...?" questions. For example, what happens if ... *the service is not*

provided by the private partner (availability risk), ... *there are not enough paying users of the service* (demand risk), ... *the new service facility does not work* (design risk), ... *new local politicians are elected who want to cancel the private provider's contract* (political risk), and so on. It must be clear which partner carries each risk. If a partner faces a risk they will try to guard against it, and that can create the **incentive to perform**. For example, if a private collector of household waste only gets paid by the local government if collection meets

DON'T UNDER- OR OVER-ALLOCATE RISK

If the public carries all risk (i.e. government pays irrespective of what happens) the PPP is not better value for the poor. Where too much risk is given to the private partner the PPP probably will not work.

agreed standards (performance risk), the collector will make sure collection is good enough to get paid. Of course if the collector is paid irrespective of how well waste is collected (i.e. the public partner carries the performance risk!), then the collector will provide a poor service because they will get paid anyway!! From this example it is clear that how risks are allocated to partners dramatically affects a PPP's performance. It also shows the main rule of risk allocation ... a risk should be given to the partner that can best manage that risk.

A key PPP value is the creativity of a private partner to find better and cheaper ways of providing a service. To get this, the public partner should focus on the **service output**, not the service input. The service output is "what" consumers will get (e.g. number of times waste is collected, how much drinking water is available, how many stalls at a municipal market are built and maintained, and so on). The service input is "how" the service will be run (e.g. whether waste

DO FOCUS ON SERVICE OUTPUTS

Specify service outputs and let private partners innovate how to best deliver the service.

is collected by truck or cart, whether water is provided by pipes or tanks, whether municipal stalls are made of concrete or wood, and so on). When the public partner focuses on outputs and gives design, construction and operation risk to the private partner, a strong incentive is created to find the cheapest service approach that works best. This shift from an input to an output focus is a big change for most local governments who in the past focused mainly on inputs.

Private partners respond to **competition**. Creating and using competition is how the public partner can ensure value for consumers. Private providers must either compete with other providers where this is possible (e.g. competing mobile phone companies), or they must compete to become the only service provider (e.g. small firms competing to operate and manage a municipal market). If private partners don't face competition, PPPs are unlikely to be effective. The process of **selecting the private partner (procurement)** is one of the most important value drivers of PPPs. A **two-stage approach** works best. First, **consult** a range of private sector players when developing the planned PPP (to make sure it makes sense for potential private partners). Second, use **competitive procurement** for selecting the actual private partner.

PRACTICAL CASES

Unfair Competition in Russia

The cost for new private, small-scale Energy Service Companies (ESCs) to enter the market in Cherepovetz, Russia, is high. They must compete with public utility companies who already provide energy services. For private ESCs to enter a contract agreement to supply

residents of a particular building they have to first make a costly evaluation of all related energy infrastructure in the building to be managed. In contrast public utility companies do not need to make this investment.

Keeping the Private Partner in Malaysia

A private company was involved from the start of a waste recycling PPP in Malaysia. There was no competition between companies to take part. After a short time the company withdrew as it did not receive 'enough publicity' and did not have a financial incentive to continue.

Business, Not Charity

In many pro-poor PPPs, initiators have focused on charity rather than the business-side of PPPs. These initiatives have been based on donations expected from the private sector, rather than on creating a sustainable business model. Many businesses have active social responsibility programmes; however, pro-poor PPPs should try to tap especially the operational side of the private sector.

Benefits for the Poor

Pro-poor PPPs must improve living conditions for the urban poor. Indirectly, PPPs at a city level can increase service effectiveness and benefit all. It can **free up time and resources** of the local government to focus on the needs of the poor. PPPs can increase basic **service coverage** in poor areas. This could be a PPP specifically servicing a poor area, possibly using an innovative (alternative) service approach developed by a private provider. It could also be by making a private provider service a poor area in exchange for the right to service a wealthier area.

DO USE PRO-POOR 'ADD-ONS'

Servicing poor areas is always challenging because of the low-income levels. Adding pro-poor aspects onto larger service PPPs (for example city level arrangements) could help more than a new PPP in a poor area alone. Add-ons could be the requirement to also service poor areas, to provide infrastructure there, or to involve the poor in service operations (job creation).

A PPP can raise the service quality in a poor area. This can be from efficiencies of a private provider (the same money buys better services) and by setting **service standards**. However, quality and standards must be balanced by **affordability**. Service costs can be reduced by alternative service approaches. Poor people can themselves also be private partners, or can work for private providers. This can create **jobs and opportunities** for wealth creation. The benefits of subsidies can go further if they are combined with the efficiencies of a private provider.

DON'T SPREAD RESOURCES TOO THIN

Be realistic. Getting a practical PPP working effectively to provide a basic service (even at low standard levels) is a good achievement and will definitely help.

PRACTICAL CASES

Water in Mozambique

In Mozambique's capital Maputo, the poor used to rely on neighbours for water, paying 10 times more than domestic consumer. Under the PPP water standpipes were rehabilitated and individual standpipe operators were selected by the community. Community water committees were trained to keep control over the operators. The poor get more water at a better price. The PPP also created jobs in the community.

Community Organizations in Argentina

Community organisations in charge of autonomous water systems in Moreno gained visibility and legitimacy from the local government. The PPP improved their management capacity, which led to concrete results such as reduction of power consumption and water pump deterioration. Increased awareness of water and sanitation issues in the community led to higher acceptance of the idea of user charges.

Linking Pro-Poor and Pro-Business in Namibia

Training for micro and small-sized enterprises in Namibia is a concrete example of the linkage between pro-poor and pro-business. By providing services, micro entrepreneurs empower themselves and the local community. Services to be provided by micro entrepreneurs include refuse collection and disposal, street cleaning, and maintenance of parks. Action plans have been developed by some local authorities for tendering and contracting out of these services.

2. Analyze the Context

When a PPP initiative begins, the context should be rapidly analyzed. In particular, look at the **service characteristics**, the **financial flows** around the service, and the **policy and legal framework**. On this basis **outline the service industry**. Doing this is important to form a better idea of what PPP arrangement is possible.

Service Characteristics

A PPP involves public intervention in a service industry – by appointing a provider, allowing a monopoly, regulating prices, promoting competition, etc. This is a serious matter. Any intervention must be both fair and improve services. You need to consider what kind of PPP is suited to the industry, and what its impacts will be. Find out and discuss what the basic

characteristics of the service are. Consider at least the following:

What are the main parts of the service?

A service usually has different parts – e.g. solid waste is comprised of 1. collection, 2. bulk transport, and 3. disposal. PPPs may be more

or less relevant in different parts. Seeing the separate parts of a service is called unbundling.

What kind of infrastructure is involved in the service and its parts, if any?

Underground infrastructure, heavy equipment, processing facilities, above ground infrastructure, community-based facilities, etc.

Is the service or any of its parts a natural monopoly?

A natural monopoly is where it makes practical sense to have only one set of infrastructure or one supplier – e.g. it makes no sense to have two sets of power lines from different power companies running side by side to a house. Electricity **distribution** is therefore a natural monopoly. However, it does make sense to have different power companies competing to generate power at lowest cost. Therefore electricity **generation** is not a natural monopoly.

Can there be multiple suppliers of the service?

If it's not a natural monopoly, several different suppliers could compete to provide the service. For example, many taxis can compete to carry commuters on one route.

Are there alternatives to the service?

Alternative options for consumers can create healthy competition. For example, if bus fares are too high people may choose to cycle or walk as an alternative. There are no alternatives to drinking water, however, although there are alternative forms of supply – piped water versus water vendors.

Financial Flows

Services must be financed. How these finances are arranged affects whether a PPP delivers value (remember risks and incentives). Start by identifying the basic financial flows and arrangements. On the cost side, a service may need **infrastructure investment** in new facilities (e.g. expanding a water network, building a new land-fill for dumping) or rehabilitating existing facilities (e.g. repairing an existing public market), regular **maintenance spending** (e.g. regularly servicing a dump truck), and **operational spending** to run the service (e.g. staff salaries, fuel, and so on). For the service you are considering, clarify roughly where funding is needed. For example, piped water needs large investment in pipes, pumps and so on. Alternatively, solid waste collection using appropriate technology (e.g. carts) needs little infrastructure but mainly operational spending. Clarify also who is currently responsible for each part of the spending.

DON'T IGNORE THE WIDER SERVICE INDUSTRY

A once-off or stand-alone PPP project unrelated to the wider service system of the city is less sustainable. Local PPPs should 'fit' into wider operational systems.

DO EXAMINE WIDER FINANCING ARRANGEMENTS

See how the PPP will fit into the wider financial arrangements of the service.

On the income side, money for the service can come from **user charges**, from government **taxation sources** (national or local), or from **external funders** (e.g. grants, donor funds, charities). If users pay for services, find out how it currently works. Who collects the money, who sets the tariff that is charged, do users pay a flat rate or according to the amount they use, what happens if users do not pay, and so on? If funds for the service come from taxes, does service payment come through the local government, the national government or another body? Does the

DON'T IGNORE LONG TERM FINANCING

Think about how a PPP would access finances over the longer-term.

government have a specific tax for the service (e.g. a local road tax), or is funding from general tax sources (e.g. property taxes)? Are the poor cross-subsidised? If external funding is involved, where is it from, how is it organised, how long will it last, etc.?

Experience shows poor urban communities can usually pay something for services. But often they cannot pay enough to cover the service costs. This means first that **affordable service levels** (outputs) should be set. Second, it means some form of **subsidisation** may be needed. A subsidy can come from other consumers, taxpayer money or external funders. But, any subsidy that is used must be combined carefully with the risk and incentive structure of the PPP arrangement to keep the effectiveness.

PRACTICAL CASES

Disconnected Contracts and Cash Flows in Russia

Private Energy Service Companies (ESC) in Cherepovetz have contractual agreements with public utility companies to provide services to residents. Residents pay to the public-run Billing Centre, which has no strict contractual obligations to transfer funds to the public utility companies, as both fall under the Local Government. Therefore it is not financially attractive for ESCs to provide services to residents, as they are not sure they will get paid.

Squeezing Standpipe Operators in Mozambique

Private standpipe operators must pay the water company for consumption by users of their standpipe. However, the users pay the standpipe operators either monthly or daily, depending on whether they have a stable income or not. Standpipe operators face cash flow difficulties, as they must pay the water company regularly, but only receive money from users irregularly.

Policy & Legal Framework

Find out the policy and legal framework for the service. In particular find out whether any existing policies or laws either promote or prohibit PPPs. Check in particular the **local government policies and laws** (most countries have a major law – e.g. Local Government Act – which sets out

how local governments function), and **local governments financial management regulations** (e.g. Local Government Financial Management Act). Check relevant **sectoral policies and laws** for the service in which the PPP is being considered – among others, these sometimes set national minimum standards. Some countries and cities also have **specific PPP policies and laws** – these are very important to know more about. Check also **city level policies and regulations** that may relate.

Most local governments have specific **procurement procedures**.

These procedures become very important later on when a private partner is selected for the PPP. Unfortunately, often procurement procedures have been developed without PPPs in mind, and are sometimes not the best procedures to select a PPP partner (for example by focusing on inputs and not outputs).

The review of policies and laws at this stage should be done rapidly. The intention is to get a general overview of the context, and identify any immediate obstacles or opportunities. Remember that policy or legal interventions may be required at a later stage to set up the PPP.

DO FIND SUPPORTING OR BLOCKING POLICIES

Identify supportive policies that may help to develop the PPP concept further. Identify possible legal obstacles.

PRACTICAL CASES

Mozambique's Water Policy

The national water policy in Mozambique includes regulations that allow municipalities to subcontract standpipe operations to private operators, who are billed according to the quantity of water used from each standpipe.

Policy in Nepal for Local PPPs

In Nepal, a national policy for local PPPs was passed. Preparing the policy took extensive consultation, which built the understanding of PPPs. Once passed the policy gave local governments a clear signal and framework within which to work. The national law governing local governments was also amended to make sure supportive PPP measures were in place.

Policy, But No Practice in Indonesia

Although a legal framework has been developed since 1999 for public-private participation, Indonesian local governments still miss practical guidance and regulated mechanisms to work within this framework.

Outline the Service Industry

Investigate and outline how the service (or its unbundled parts) is currently arranged, if at all, both in poor areas and in wealthier areas or at the city level. Questions to consider are:

Is there already a formal service provider? How effective is it?

Possibly the local government? For which different parts of the service is the formal service provider responsible? Are poor areas covered? What level of service is provided? Is service quality acceptable? Is a wider level PPP arrangement already in place (does the local government work with other partners, e.g. a formal private partner, informal service suppliers or community)?

DO CONSIDER CURRENT SERVICE PROVIDERS

Understand what impact the PPP may have on existing (informal) suppliers.

Are informal service suppliers operating?

Water vendors, garbage scavengers, etc. A new PPP could put them out of business. Or could they perhaps be the private partners?

If big infrastructure is involved, who owns it?

Possibly the local government. Big infrastructure needs investment and maintenance. Ownership becomes important for these issues.

Are there any domestic banks or investors involved?

Is infrastructure or provision financed with money from outside the local government?

Who are the beneficiaries?

Are they only beneficiaries or are they also involved in the service provision? Can they afford the service and are they satisfied?

What are the characteristics of the stakeholders?

Make a list of the competencies of the stakeholders (management, expertise, resources, knowledge). What are the stakeholder's benefits in the existing service provision and what are the motivations (market driven or community development) in providing the service? What is the attitude of local government towards working with different stakeholders?

Where and what are the main problems with the existing service arrangements?

What constraints does the service provider have in providing the service? Is it in the area of management capacity, contractual/legal, technical expertise, finance, communication, willingness or affordability to pay?

Your understanding of the local service industry is critical to developing an effective PPP. It may require some additional research or advice to develop a good picture of the service industry.

PRACTICAL CASES

Studying Water in Argentina

An analysis was carried out of the water and sanitation service provision system across Moreno, Argentina. This involved compiling information scattered in different departments of the municipality. The results were tested through workshops with community organisations. This approach allowed an accurate knowledge of the water and sanitation service provision to be developed.

Identifying Pro-Poor Services in Namibia

Local authorities in Namibia have been encouraged to categorize services and service providers so that it is possible to identify which services and providers are pro-poor.

Missing Existing Providers in the Philippines

A local government in the Philippines set up a new joint venture to recycle household waste. The initiative did not consider existing recyclable collectors and a private separating facility in the area. The joint venture had an unfair advantage – support from the local government partner. Nevertheless, the private operator continued recycling more effectively than the joint venture.

Unexpected Competition in Malaysia

In Malaysia, a PPP to collect separated household waste discovered too late that a religious charity group had already been collecting glass and paper from these households for many years. People preferred to give their glass and paper to the charity group, rather than the new PPP collectors.

Involving the Professionals in Russia

As part of investigating a possible energy PPP in a Russian city, many professional organizations involved in maintaining heat and water supply systems in public buildings and in maintaining heat meters in residential buildings were identified. These organizations were considered to be a good basis for the establishment of private Energy Service Companies as they already had considerable industry knowledge and experience.

3. Develop Initial PPP Model

The main PPP sponsors should now understand what makes a PPP effective and more about its specific context. On this basis the key aspects of a possible PPP arrangement should be outlined. This outline will be used later during consultation with wider stakeholders and as the base to prepare a proper business plan for the PPP.

Focus on reviewing the **PPP options**, making a **risk / incentive matrix**, outlining possible **financing arrangements**, and on this basis writing an **outline PPP structure**.

PPP Options

PPPs can be set up in different ways. The arrangement must specify who the partners are, their responsibilities and rights, how they will work

together, how the money flows, and so on. This is almost always written down in a **contract**, which the partners sign. For complex PPPs these can be large contracts prepared by legal experts. For other situations – e.g. an entrepreneur from a poor community who gets the right for 6 months to collect waste in an area using a horse drawn cart – it can be written on a single page. The contract must specify in a **clear and practical** way the key parts of the PPP arrangement.

DO LOCALIZE THE CONCEPT

If possible put PPPs into terms and names that are locally understood. Many places have forms of PPPs operating but call them something else.

There are a few common ways in which PPPs are arranged. A public partner can hire a private partner with a **service contract** to provide a specified service for an agreed payment and duration. Examples include street sweeping, revenue collection, and meter reading. With a **management contract** more responsibilities are given to the private partner to operate the service, although any infrastructure (e.g. trucks, water pumps) is owned by the local government who also makes decisions about further investment. Management of wastewater treatment or solid waste disposal plants are examples. Under a **lease contract**, the infrastructure is rented from the public owner by a private partner who operates and maintains it to provide the required service. For example, a company can lease a bus terminus from a municipality for 5 years (i.e. the company pays the municipality each year) and run it for this time. In return the company can collect drop off fees from the bus company and could rent out shop space in the terminal. With a **concession contract** a private partner has full responsibility to deliver a service, including any investment required, for a period of time. Concession contracts are usually longer than lease ones to enable the private partner to recover its investment costs. The well-known **B.O.T. (Build Operate Transfer)** arrangement and several variations requires a private partner to build infrastructure, operate it for an agreed period, and at the end of that time transfer the infrastructure back to government.

In practice, PPP arrangements are often combinations of these common options. The name – a concession, a lease, a BOT, etc. – is not important. But what is vital is that the main parts of the PPP arrangement are clearly spelled out:

Who will own any infrastructure involved?
Who is responsible for investment if required?
Who must maintain any infrastructure involved?
Who will collect revenues?
How will payments to and between partners be made and when?
How long a period is the partnership?
Who will set service standards?

How will performance be monitored and by whom?

What will be the penalties for non-performance?

What can communities do if the service is not right?

How will tariffs be set and by whom?

And so on...

Keep a list of these and similar issues and how each can be addressed.

Risk / Incentive Matrix

Sharing risks and incentives between public and private partners drives a PPP's value and effectiveness. It is vital therefore to be clear about how risks and incentives can best be structured. Doing this needs at least three steps: identify risk, allocate risk, and consider incentives.

Identify the main risks

Make a list of the main risks involved (*What if ...?* questions). One way to do this is to think of risks at each stage of the service: planning, design, construction, operation and maintenance, close. Have an idea of what each of these risks means in practice.

Which partner should be responsible for each main risk?

The risk rule is that a risk should be given to the partner who can best manage that risk. For example, the public partner should carry political risk, and the private partner the commercial risk. Some risks, such as force majeure (earthquakes, floods, etc.), can be shared by both partners. For each of the main risks identified, indicate which partner should be responsible, or whether it is a shared risk.

DON'T MAKE VALUE JUDGEMENTS ABOUT THE MOTIVES OF PARTNERS

It is unrealistic to expect all partners to think in the same way about the urban poor. The aim is for partners to meet their own needs but in a way that also benefits the poor.

Consider the performance incentive that the risk allocation gives to partners

List which risks each partner will be expected to carry. Think through what performance incentives these risks will give to the partner. Review again how this performance will result in benefits to the urban poor.

The risk matrix is initial and will require adjustment later. Often there is a tendency at first to try to put too much risk onto the private partner. At this stage, the important point is to start to think through how the risk and incentive structure will work. The precise allocation of risks and incentives between partners will feature eventually in the process of tendering and awarding the PPP. Having a good understanding at the start of the process is essential.

PRACTICAL CASES

Government Carrying All the Risk

In one Asian PPP for solid waste collection, the private partner has strong links with the local government, which besides providing all financing is effectively carrying most of the risk. The private partner does not face any competitive threat and has unclear responsibilities. This arrangement prevents the local government from playing its regulatory role effectively and does not incentivize the private partner to perform.

Financing Arrangements

Consider the possible financial arrangements. Two aspects must be considered: the financial arrangement of the PPP itself, and affordability of the PPP to the public partner and consumers.

PPP Arrangements

If new or large investment is required, which partner will be responsible? How will revenue be generated to pay for the service? If there is a user charge, who will determine the tariff? Which partner will collect revenues (either taxes or user charges)? How and when will the private partner be paid (either by being allowed to collect revenues or get access to some other

DO BUILD INFORMED DECISION-MAKING

The local government must understand the long-term nature of PPP agreements, and their impact on the budget.

funding stream such as rentals, or payment from the public partner)? How will the payment stream for the private partner be linked to performance? This last question means the risk / incentive matrix and the financing arrangements must

be looked at side by side. Is external funding likely to be involved (e.g. a bank loan) and whose responsibility will this be? Will the public partner provide any guarantees or collateral?

Affordability

This has two parts. First, can the public partner afford the PPP in years to come? The local government must understand the **budget implications** of the PPP. The public partner may have to make regular payments to the private provider. Funds must be available in the local government budget to make these payments (for the duration of the PPP which can be many years). If the PPP gives the private provider the right to collect revenues, the local government will be foregoing getting this money itself. This reduced income must be considered in the budget (possibly by reducing expenditure – e.g. closing the municipal water department if this water will be privately provided in future).

Second, can consumers afford the PPP? Service **standards** must be set as low as possible to make services affordable. If consumers cannot pay the required user charges, a **subsidy** must be designed. Which funding sources could be

used? How will the subsidy be set up so as not to reduce the effectiveness of the PPP?

Outline PPP Structure

At this stage an outline of the possible PPP arrangement should be written down. This should be a general outline of how the PPP would be structured and would operate. The description (possibly just a few pages long) should bring together the main issues raised so far. The outline should cover:

Proposed PPP Concept for [*Basic Service*]

1. Service

- The service or part of the service to be provided (e.g. household solid waste collection, municipal market maintenance, etc.)
- Which parts of the service will not be included and who is responsible for them (e.g. the PPP will not cover waste disposal which is conducted at the municipal land fill site)
- The main outputs expected from the service (e.g. household waste is to be collected twice weekly from each house)

2. Recipients

- Geographic area of the service (e.g. zones 6 and 7 of xyz city, the central bus terminal building and adjoining parking area, etc.)
- Main users of the service (e.g. the 250 houses making up zones 6 and 7, bus commuters using the central terminal building)
- Description of users (e.g. numbers, approximate income levels, special characteristics)
- Pro-poor benefit (how the urban poor are expected to benefit)

3. Arrangement

- Public partner (who will be the main public partner, what are the main responsibilities / roles, will the private partner enter a contract with this partner)
- Private partner (what kind of private partner is expected, will there be one or many private partners, what will the private partner/s be expected to do)
- Structure (between which partners will contracts be needed, how long should the contracts last)
- Payments (who will pay, who will be paid, who will collect revenues)
- Risk allocation

4. Regulation / Performance Monitoring

- Responsibility and approach for tariff setting if appropriate

- Responsibility and method of performance monitoring of the private provider
- Role of consumers in performance monitoring and regulation

5. Procurement

- The strategy to identify and appoint the private partner using competition

The outline does not need to be very long or complicated (maybe just a few pages in length). Some issues mentioned above may not apply, and other issues may need to be raised. Mostly, it is important to have the key aspects of the PPP roughly worked out. Changes will likely be made as the PPP is discussed with stakeholders and further developed. However, there should be a good understanding of the PPP from the beginning.

PRACTICAL CASES

Getting Practical Too Late

Substantial awareness-raising processes for PPPs in waste separation and recycling were conducted in three pilot areas on Penang Island, Malaysia. However, there was not a clear idea of what workable PPP arrangements could be put in place. This had several consequences, including: a private company was chosen to take part without competitive tendering; the collection system was based on volunteers; the pilot PPP schemes were not connected to wider solid waste collection systems; it was unclear what the financial flows would be in the longer term.

4. Design Process

You now have an outline of a proposed PPP for the basic service that takes the key features of an effective PPP into account. A process should be designed to develop the outline into a full business plan for the PPP. This process involves **consultation**, identifying **intervention points**, and organising **additional support**.

Consultation

The purpose of consultation is to **inform** stakeholders of the proposed PPP, to build their **support and involvement**, and to further **develop the PPP arrangement** based on their feedback.

DON'T LET ONE PARTNER DOMINATE

Where one partner – private or public – dominates too much, PPPs seem to fail.

At the core of most PPPs is a signed contract (or similar agreement) between a public partner (usually the local government) and a private partner (an individual or company, formal or informal). However, there are many more who may have a stake in the PPP. These **stakeholders** include: communities and users of the service;

CBOs; local government and other government bodies (political level and officials); NGOs; local private companies, both informal and formal; business associations; foreign companies and investors, domestic investors, including at community level (such as credit groups) and wider institutional investors (such as pension funds and insurance companies); trade unions; domestic and foreign banks; other agencies and organisations; experts, professionals and consultants.

DO USE COMPETITION AND TENDERING

The private partner must always face competition and be selected competitively.

Work out an approach to inform and consult the relevant stakeholders. You can divide them into

primary stakeholders, who are directly affected by the PPP or can directly affect it, and **secondary stakeholders** who are less directly involved. Focus especially on the primary stakeholders, and pay special attention to the service beneficiaries.

Consider who will be consulted, why they will be consulted and how? The process can include public meetings, workshops, forums, and newsletters; ICT. Individual meetings with key stakeholders are very important. Setting up a body, such as a **local PPP committee** of the local government, the local business association and community representatives can also be useful. Usually the local government should play an important (central) role in the consultation process.

Consultation with possible private partners is very important to test whether the PPP will be sellable. However, this consultation should be to test the PPP design, and not to select the private partner. A **two-stage process** is recommended. Stage one, test the PPP concept and design with the broad private sector (through business chambers and wider consultation). Stage two, select the actual private partner through a competitive selection process.

DON'T SELECT A PARTNER WITHOUT COMPETITION

Tendering to select the private partner is usually required and necessary.

The consultation you plan should build an informed support base for the proposed PPP. It should also provide feedback on how the design of the PPP should be improved.

PRACTICAL CASES

Awareness Raising Campaign in Namibia

The PPP concept was promoted with key stakeholders in 13 regions of Namibia. As part of the campaign, 'Guiding Principles and Policy Guidelines for PPP Projects' issues by the Ministry of Regional and Local Government was widely distributed to governmental and private actors. The guideline document was used in a variety of settings to facilitate dialogue among different stakeholders.

Starting a Pro-Poor PPP for a Basic Urban Service

National and Local PPP Units in Nepal

A PPPUE sponsored national programme to support local pro-poor PPPs in Nepal was managed by a PPP Unit jointly funded and staffed by the national government, organized local government and organized business. Having both public and private parties genuinely involved was critical to success. National business associations spread the concept of PPPs through their local branches. Similar PPP committees were set up in pilot cities, with local government, local business chambers and other stakeholders involved. These consultation processes at national and local level made sure a proper understanding of PPPs was conveyed to stakeholders. It also created an enabling environment for the PPP deals that followed.

A Complex Project Needs More Consultation in Russia

Representatives of private Energy Service Companies (ESCs) actively participated in residents' meetings, forming a dialogue between private service providers and consumers. However, the current situation shows that this was not enough. Residents are not yet convinced that forming an Association of Communal Service Payers and contracting ESCs for energy provision will bring them sizable benefits. Some aspects of PPP arrangement are difficult for non-specialists to understand. These and contractual aspects should have been simplified and explained in detail to residents.

Intervention Points

PPPs are a novel approach to the delivery of services. As you have been working on the various steps of starting up a PPP you will probably have come across possible obstacles and opportunities. **Obstacles** you may have noticed could be: that most people are unfamiliar with how PPPs work; no supportive policies are in place; the primary stakeholders may not trust each other; the community sector may lack the necessary skills and capacities to play an active role; the private sector may be absent altogether; the public sector may not have experience in negotiating a PPP project.

But you probably will have found **opportunities** as well: many informal service suppliers already working in poor areas; an active and interested private sector; a wider decentralization and local government reform process; a key local politician interested in implementing PPPs; an external agency interested in offering support.

How can these be used when taking the PPP development further? Such intervention points should be identified so future efforts can be strategically focused.

PRACTICAL CASES

NGOs Too Dominant in Mozambique, Argentina and Malaysia

In Maputo and Argentina, international NGOs were strongly involved in efforts to set up local PPPs. These NGOs played a very dominant role. Although

responsibilities were shared between partners, in practice it was the NGO managing the process. Real private sector involvement was low. In Malaysia, private companies were unwilling to take part, accusing the NGO of not being open to their ideas.

Political Champion in Philippines

Initial efforts to establish a PPP in a city in the Philippines were greatly helped by a high level political champion. This politician strongly promoted the PPP concept and facilitated discussion with the private sector. This champion is now the Mayor of the city.

But Bad Press Hampers PPPs

The Philippines has a long history of PPP activity and many years ago passed both a "BOT law" and established a "BOT office" within the government. In general, however, cooperation between government and business has been hampered by perceptions of high political risk and general wariness of the private sector to work with government.

Additional Support

To develop a more detailed business plan for the PPP additional support will probably be required. Information on some sources of PPP expertise is given at the end of this Guideline. Support should be organized. One option is to form a small **task force** of the main sponsors of the PPP. The task force should oversee the consultation process and organize for additional expertise when needed.

An important source of support can come from PPP experiences elsewhere in the relevant city, country or region. Being able to see an actual PPP in operation can be extremely useful. It also lets the main PPP sponsors see how their counterparts managed the process. **Practical examples, standard contract clauses and case studies** can all help to build understanding and reduce development costs. Some countries have set up **PPP support units** either at local or national levels to do this.

Setting up the PPP may need **specialized expertise**: legal, financial, technical. Advisors may need to be hired for this. **Local consultants** experienced with PPPs may, or may not, be available. Look also for other successful PPP examples nearby (other parts of the city, nearby cities, adjoining countries, etc.) and consider approaching the persons who were involved in that. Access **private sector expertise**. This can be through a business chamber or association during earlier development stages (e.g. in Nepal the national PPP unit is partly funded and staffed by the national business chamber).

Additional **external (or international) experts** may be needed if local PPP expertise is not yet

DON'T REINVENT THE PPP WHEEL
Reduce the costs of preparing a PPP by using the experience and materials (e.g. service outputs, contracts) developed elsewhere.

developed. Higher costs often make using external experts more difficult. Most important, whether local or external consultants are used, make sure they have the right skills and proven experience in setting up PPPs properly. Remember that support may be needed not just to set up the specific PPP itself, but also to prepare its policy framework, and understanding among stakeholders.

Apart from technical support, **external funding** support may be needed. The various donor agencies are one source. In addition, many bi-lateral, multi-lateral and private financing institutions have special funds or programs for PPPs. They often also provide capacity development, facilitation and technical support for setting up a PPP. Several of these funding sources are listed at the end of the Guideline.

The **PPPUE Toolkit** provides extensive technical guidance and support. A number of similar manuals and toolkits exist which can also be used.

PRACTICAL CASES

PPPUE and the Innovative Project Grants

The IPG program itself is a good example of external support for local PPPs. It has been influential in setting the right framework for PPP initiatives, through focus on awareness creation, capacity building, building relationships between partners and promoting policy and legal frameworks. Uganda, Nepal and Namibia are examples where a national enabling environment has been supported. IPGs have also been used in individual cities to get local PPPs underway. In addition to the particular projects involved, this has generated considerable learning on how to make pro-poor PPPs work for the poor.

Practitioner PPP Exchange in Philippines

A PPP project used training and capacity services from local universities in the Philippines that are involved in the PPPUE Global Learning Network. A delegation of practitioners from Malaysia was also hosted to view the project and exchange experiences. This form of direct practitioner exchange is a very powerful method of enhancing capacity.

Nepal and India Exposure Visits

Seeing PPP projects working in practice is probably the best way for stakeholders to understand how they work. A cross section of Nepal PPP stakeholders visited an Indian city to see several operating PPPs. PPP practitioners in Nepal also visited Nepalese cities where initial pro-poor PPPs had been set up. These external and

internal exposure visits transferred practical knowledge to PPP sponsors and served as a source of inspiration. A range of new PPP projects was initiated as a result.

Going Forward

Using this Guideline ensures that the features of an effective pro-poor PPP for a basic urban service are built in from the start. By covering four steps – 1. Build Understanding, 2. Analyse the Context, 3. Develop Initial PPP Model, and 4. Design a Process – the main PPP sponsors should be headed toward a PPP that will deliver value for the urban poor.

An initial model of an effective PPP is now on the table. This model is based on how PPPs work, their value drivers, and the benefits for the urban poor. It is also based on a good understanding of the specific context (service characteristics, financial flows, policy framework). The model includes an initial idea of how risks and incentives will work, finances be arranged, and the partnership structured. A process has been designed to consult stakeholders and mobilise additional support to develop a **formal PPP business plan**.

A variety of practical examples, cases, 'Do's and Don'ts' based on PPPUE experience, and information on where to get further support has been provided in this Guideline. PPP sponsors should also get a copy of the PPPUE Toolkit.

Finding Further PPP Support

Specialised PPP support is available worldwide from many agencies, management-consulting firms, academic institutions, law firms, banks and individual experts. An extensive list of organisations and experts worldwide, and the support they offer, is maintained by PPPUE. PPPUE also operates the Global Learning Network, an online source and referral centre for PPP practitioners, and has a detailed PPP Toolkit available online. Please visit the PPPUE website

<http://pppue.undp.org>

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Examples of Pro-Poor PPP Issues in Contracts

Many features of an effective PPP end up in a contract signed by the main public and private partners. Below are examples of how PPP features can be put into a contract.

Service output for a PPP to provide drinking water through water vendors:

"The private operator will ensure that the defined minimum amount of potable water is made available to each household weekly within the designated area for the duration of the contract period".

Defining the service output in a solid waste collection PPP:

"The service to be provided by the private operator will result in the collection of household waste from each household within the designated area at least every third day for the duration of the contract period".

Allocating performance risk to a private manager of a public market:

"If market stalls cannot be used by vendors due to poor physical conditions, then the local government will stop monthly payments to the private manager until the stalls are returned to their required physical condition".

Specifying asset ownership in a PPP contract to manage a municipal market:

"All physical structures in the designated market area listed on the attached schedule will remain the property of the municipality, who will be responsible for their continued maintenance".

Asset ownership and maintenance in a PPP for operating and maintaining a municipal parking facility:

"Ownership of existing municipal physical structures related to parking (listed in the attached schedule) will be transferred to the private operator for the period of the contract. Any additional physical structures for parking constructed by the private operator will be under the ownership of the private operator for the duration of the contract. At the end of the contract period the ownership of all physical structures will be transferred to the municipality. The private operator will be responsible for the maintenance of all physical structures under its ownership during the period of the contract".

Capital investment responsibilities in a PPP to construct a tolled pedestrian bridge over a river:

"The private company is solely responsible for obtaining all the necessary finances to undertake the construction of the bridge, including all and any related financing charges, as well as the ongoing operation and maintenance of the bridge for the duration of the contract period".

Investment in a PPP to operate and maintain public toilets:

"The municipality will finance the initial construction of the public toilets. The private operator will finance any required maintenance of the public toilets for the duration of the contract".

User charges and tariffs in a small-scale electricity provision PPP:

"The private operator may bill and collect payments for electricity used by consumers within the designated area for the duration of the contract period. The operator may not charge more than the maximum tariff specified annually by the Local Electricity Commission (regulator)".

Availability risk and penalties in a PPP agreement to build and provide a community hall for 15 years:

"The municipality will pay the private partner twice yearly provided that the community hall is available at the specified service level. The municipality will deduct from the payment on a pro rata basis for every day that the community hall is not available at the specified service level".

Regulating prices for a single authorized abattoir (slaughterhouse):

"The municipality, in consultation with the private abattoir operator and the relevant consumer bodies, will approve at the beginning of each year the charges to be levied that year for the slaughtering of animals. In making its decision, the municipality will take into considerations the factors outlined in the attached schedule".

Performance monitoring and penalties for a private household waste collector:

"The sub-municipality will regularly monitor whether the private operators collect household waste from all relevant households at the specified frequency and service level. Any failure to perform the service will be reported to the local government, including details of the date, place and nature of failure. The private operator will have 12 hours after notification to rectify the failure. If the private operator does not rectify the failure within the specified period, the local government will deduct payments based on the attached schedule of penalties".