PPP at Cross Roads : Alternative Models an Imperative

Mohan B. and Latha R. Nair

Abstract

The waning enthusiasm for PPP projects in India is a serious setback in the growth plans of the country. PPP models were expected to attract the elusive private capital to the infrastructure sector of the country. The high management efficiency the private sector is deemed to possess, would help to make the PPP model infrastructure development a success story in the country. However, the scenario unfolding is proving to be different. Many of the PPP initiatives, of late, gained the ill-repute of having poor quality in service delivery and dragged the government into litigations. The time demands alternative models which taps the investment potential of the Indian middle class for infrastructure.

Keywords: *PPP, risk, return, public service, alternative models*

Dr. Mohan B.
Associate Professor
SCMS Cochin School of Business
mohanb@scmsgroup.org

Dr. Latha R. Nair
Assistant Professor
Department of Computerscience
CUSAT
Latha5074@gmail.com

Governments across the globe have turned towards private sector to provide infrastructure services in power, energy, transport, communication etc. which were traditionally delivered by government agencies. The result was an organizational innovation called 'Public Private Participation.'

The reasons for luring private sector are many.

1. Availability of additional resources to meet the increasing demands for infrastructure service development
2. Increased efficiency in project delivery and operation
3. Access to newer technology from private/public sector, and
4. Sustainable development in infrastructure facilities

However, across the world, the record of PPPs has been very mixed. PPP projects have been mired in issues such as disputes in existing contracts, non-availability of capital and regulatory hurdles related to the acquisition of land. This has

resulted in a waning interest in PPP projects as such. However the concept is a powerful tool with unlimited potential. This paper after discussing the basic tenets of PPP sees the popular PPP models in India through a critical prism and positions CIAL (Cochin International Airport Limited) as a reliable alternative.

2. Literature Review

The first reported PPP model in history is in the year 1438 when concession right was granted to a French nobleman Luis de Bernam to charge fee for the goods transported on river Rhine. By the turn of seventeenth century many instances of participation of private capital in public investments for the construction of infrastructure facilities like water channels, roads, railways were reported in America, Europe, China and Japan. In 1992, United Kingdom started implementing Private Finance Initiative (PFI) as a comprehensive government programme for undertaking projects such as roads, subways, prisons, national defense, health care and housing in a big way. This way public sector became a purchaser of services from the private sector who provided the necessary fixed assets and management efficiency for creating it.

The World Bank Group defines a PPP as "A long-term contractual arrangement between a public entity or authority and a private entity for providing a public asset or service in which the private party bears significant risk and management responsibility."

As per US laws Public-Private Partnership (or PPP) shall mean a single, long term, performance-based agreement between a responsible public entity and a private developing entity for the development of a qualifying project, in which appropriate risks and benefits can be allocated in a cost-effective manner between the contractual partners and where ownership of the Qualifying Project remains with the Responsible Public Entity, and the operation, if any, and maintenance of the Qualifying Project may revert to the Responsible Public Entity at the end of the contract term.

European Commission sees PPP as cooperation between the public and private sectors for the development and operation of infrastructure which is a direct result of efforts to increase the quality and efficiency of public services, insufficient public sector financial resources to cover investment needs coupled with spending restrictions and a desire to access private sector efficiencies[7].

The PPP model envisaged by Asian Development Bank (ADB) acknowledges the role of government as a body to meet social obligations for providing infrastructure services mainly engaging the private sector. It will facilitate this by making necessary sector reforms. It ensures that the targets on Public investments are achieved in the process. Such a PPP format is to allocate the tasks, obligations, and risks among the public and private partners in an optimal way. While the public partners in a PPP can be government entities, the private partners can be local or international and may include businesses or investors with technical or financial expertise relevant to the project. Increasingly, PPPs may also include nongovernment organizations (NGOs) and/or community-based organizations (CBOs) who represent stakeholders directly affected by the project.

The Government of India considers PPP as 'an arrangement between a government, a statutory entity or government owned entity on one side and a private sector entity on the other, for the provision of public assets and/ or related services for public benefit, through investments being made by and/or management undertaken by the private sector entity for a specified time period, where there is a substantial risk sharing with the private sector and the private sector receives performance linked payments that conform (or are benchmarked) to specified, pre-determined and measurable performance standards.

2.1 Common features in the definitions of PPP

The following features of PPP are highlighted in all the above definitions

1. PPP is a mechanism for providing a public service.
2. The private sector entity is expected to take a greater share in funding the PPP project.
3. The management expertise of the private entity will be available for the project
4. The private and public entities share the risk depending on their ability to handle.
5. The final ownership of the facility will be with the public entity.

3. Common ppp models.

The commonly operated PPP models are given below[10]. These varied models of PPP fit in a continuum between management contract and total private investment.

1. **Service/Management Contract**

   The private entity contracts an existing facility for providing services on the basis of a bid. The ownership of the facility rests with the public entity. The private entity collects the charges from the public entity.

2. **Affermage /Lease**

   The private entity takes over the facility on lease and provides the services required as per the lease agreement. The public entity receives lease rental from the private entity. The ownership of the facility rests with the public entity. The private entity charges the users for the services provided.

3. **Turnkey projects**

   The private entity designs, builds, test runs and hands over the facility to the public entity. The ownership of the facility rests with the public entity.

4. **Concessions**

   The private entity builds the facility and operates it for an agreed period after which the facility is transferred to the public entity. The ownership of the facility rests with the public entity. The types of concession agreements are Build Operate and Transfer (Toll), Build Operate Own and Transfer, DBFOT (Design, Build, Finance, Operate and Transfer).

5. **Private Finance Initiative**

   The private entity designs, builds, owns and operates the facility. The charges for the above activities are received either from the public entity directly or as annuities from the public entity. An example for this model is BOO (Build, Own and Operate).

6. **Divestiture**

   It is the process by which public ownership of a facility is transferred to a private entity for a price.

4. Foundations of The Structure of Ppp Models

1. Risk allocation according to the ability to handle

Any project has to face risks of varied kind right from its conceptualization to implementation and service delivery. The fundamental premise in PPP mode is that each risk has a premium and the allocation of risks to private and public entities is done according to their abilities to manage them ex ante and ex post. This arrangement will entail final delivery of service at a lower price as allocation of risk is as per the greatest and most relevant expertise to manage them and optimal efforts are engaged for mobilization. This will also ensure that the project is protected against optimism bias.

2. Value for money (VFM)

The price of services to be measured against most value for money for the services offered. The quality of service delivery is as important as economy in its provision. The cheapest way in which the services can be delivered alone is not the determining factor.

3. Life cycle cost and risk

The operator has to plan for life cycle costs and risks of the project right at the design or mobilization stages as he is responsible for life time service delivery from the asset created. Hence he will be responsible for the systems integration as well. There is an incentive for him to ensure quality asset creation and integration which will entail less operating cost and better VFM in service.

4 Private hands to control output

Unlike private projects where prices are generally determined competitively and government resources are not involved, PPP projects typically involve transfer of public assets, delegation of governmental authority for recovery of user charges, private control of monopolistic services and sharing risks and contingent liabilities by the Government. Typically, a private sector consortium forms a separate company called "Special Purpose Vehicle (SPV)" to develop, build, maintain and operate the asset for the contracted period.

The involvement of the public sector in the day to day operation of the facility ceases to exist. The role of public sector is limited to monitoring and regulating provision of service. This way the project is protected against political and administrative interferences which normally are the causes of delays and cost overruns.

5. **Higher cost of private capital to be factored in the price of service delivered**

The cost of private capital is higher compared to that of government. Additionally, the long gestation period of the projects and the higher ratio of debt to equity (70:30) in the capital make the capital even more costly.

6. **Incentive for quality and timeliness in service delivery**

The higher efficiency, quality and timeliness of service impact the prices and raise them as long as they fit into the concept of VFM.

7. **Existence of an appropriate legal, political and social environment**

PPPs can function effectively in a congenial, legal, social and political environment which will not only approve, accept and facilitate inception and functioning of appropriate PPP structure but also will provide a framework for amicable dispute resolutions.

8. **Drawing the expertise from private sector**

Private sector boasts of sufficient expertise in its ranks to create and operate centers of excellence. PPP facilitates utilization of this capability for public service.

The basic intent of PPP is to encourage the private sector to dedicate its capacity to raise capital, to utilize its ability for timely project completion, and to utilize its resources for the welfare of the community without having to compromise the profit motive and to make them accept the responsibility to provide goods and services to the public at affordable rates. This arrangement, indeed, calls for a judicious approach to decision making and underscores the need for a framework that enables the private sector partner to make reasonable returns on investments without diluting the standards and quality of services provided. The key to the success of PPP projects is a balanced and fair sharing of risks and benefits between the partners, and transparency and accountability in all transactions relating to the award and management of the contract.

5. Risks associated with PPP infrastructure projects

5.1 Pre Construction risks

1. Land acquisition – A major risk that can make the whole proposal meaningless, escalating costs and time overruns . This risk is absorbed by the public entity.
2. External linkages – Timely connectivity to the outside world – absence of which may escalate the cost.
3. Financing risks – refers to the risks that adequate finances are not available to the project at a viable rate resulting in delays in financial closure at a prescribed time.
4. Planning risks – Pre development studies conducted (legal, technical, and financial) are inadequate and not robust enough resulting in possible deviations from the expected outcomes.
5. Approval risks – The risk that needed approvals will be delayed or will not be granted. Possibility of getting all the approvals was very strong provided the construction was to the specifications.

5.2 Construction Phase Risks

a) Design risk – Refers to the risk that the prosed design will not be able to meet the service requirements.

b) Construction risk - The construction may not be completed in time.

c) Volume risk - Demand for service may vary from forecast. The emergence of Kerala as a favorite tourist destination and the gulf boom ensured that the volumes only grow with time.

d) Payment risk – The fee for services is not collected in full or not set at a level that permits recovery of costs. Payment Airport services could not be defaulted by airline operators for long.

e) Financial risk – Concessionaire has brought in too much financial stress on a project by using in appropriate financial structure for the privately financed components of the project. It can result in additional funding costs for increased margins.

f) Environmental health and safety risk - Damage to the environment more than that was originally addressed in the mitigation plan. No additional constructions beyond approved planning were done.

g) Hand over risk – Concessionaire will default in handover of the asset at the end of concession period. Or will fail to meet the minimum quality standard or realizable value at the terminal stage that need to be handed back to the public entity.

6. Ppp Programme in Infrastructure - Challenges Faced In India

PPP is considered as the most potent tool for developing infrastructure in India. However the growth rate of PPP projects is not commensurate with the infrastructure needs of the country.

The country is yet to come up with a national PPP policy which will address the key issues facing PPP programme implementation. Government is planning to set up 3P India, a think tank to aid PPPs to restructure PPPs to devise new models and to act as a professional risk appraiser.

1. Private players - inadequate in number and lacking in capacity to deliver infrastructure services to the scale needed.

Inadequate number of private players in the infrastructure sector leads to concentration of projects in few major players. The different private players operating in the different segments of the project are not able to integrate their areas well so that the final delivery of the service is flawless. 70% of contracts in highways sector, are limited to 35-40 players.

2. Unconvincing institutional set up

The PPP institutional set up is plagued by poor bidding processes, poor project structuring leading to complaints of improper division of risk and responsi bilities, change in scope due to changing technologies, political environment and public demand. The institutional frame work lacks competencies to devise specific PPP models that projects demand. Model Concession Agreements becomes sacrosanct missing the key issues to be addressed.

3. Need for increasing public share in infrastructure investment

National Transport Development Policy Committee (NTDPC, 2014) projects that overall infrastructure investment will need to increase substantially from around 5.4 percent of GDP in 2011-12 to around 8 percent during the 2020. The share of public sector in infrastructure investment is projected to be around 57 percent of the total infrastructure spending in 2017-22. In view of the difficulties that have now emerged with regard to the implementation of PPP projects, and their financing, it is possible that the role of public investment in infrastructure may need to be higher than what is projected here.

4. Gold plating risks

World order has changed and mobility of goods and services across borders has improved. Countries are co-operating to develop common infrastructure so that trade across nations are easier and faster. The need for improving infrastructure is understood and felt by all. The construction technology has improved a lot reducing the cost of construction and period of construction. In other words the risks associated with a project are not as severe as often projected. It can be seen that of the many risks associated with an infrastructure project the major risks are handled by public sector entity. One needs to be vigilant against the tendency to 'over engineer' the projects and to pad the total capital expenditures.

5. Management capability

The executing entity needs to have excellent project management and O&M capability, and must be able to demonstrate its commitment to the partnerships. It must not merely look forward to making profits at any cost, but must be committed to providing sustainable and quality service to the customers.

6. Demand for incapacitating rules of land

The PPP sectors often demand dilution of safety and welfare rules applicable during the construction and operational phases of the project, the private sector prominence in the structure taking advantage of its association with public sector. Such moves create asymmetry in the welfare promise that the state guarantees for its citizens.

7. Lack of transparency

The PPP project proponents demand that PPPs should be excluded from the ambit of "Right to information act' as a necessary guarantee for operational freedom. Demands of this sort is an infringement on the right of people to know the conditions on which they are provided with the service and to get convinced that no collusion exist

between the regulator and the dominant PPP partner. Lack of transparency will adversely affect the acceptability of PPP programme in the society.

8. **Rate revision of awarded contracts**

There is a growing tendency among the operators to claim overshooting of costs due to delay in executing contractual obligations from Government however trivial they may be and claim compensation through appeals for upward revision of agreed rates. This is seen to be accepted by Government agencies in many cases. The collusion of corrupt officials with private operators is a bane that PPP programme is required to handle and overcome.

9. **Risk of handover of the facility to the public sector**

India lacks a culture of proper record keeping of the various assets that the operator is required to create and maintain. Given the socio politic environment prevailing in the country and the long concession period of 25 to 30 years that is normally associated with agreements the risk of hand over of the facility in the originally envisaged shape and condition at the end of the service period very much exists. An office of PPP assets authority is very much required to ensure that no dilution takes place over a period of time.

10. **Over emphasis on private sector investment**

The current PPP models in infrastructure place heavy emphasis on private investment and the system looks over-enthused to incentivize it. Once the private sector interest in a particular sector falls the development of that sector will hit a trough- which happened in South Asia during 2012, adversely affecting provision of services in that sector. To overcome this threat retail investors are to be attracted in large numbers to invest in PPP. The present models are not adaptable to this need.

11. **Denial of opportunities for retail investors to invest directly in infrastructure projects**

A properly designed and executed infrastructure project gives good return. The private equity engaged for infrastructure PPP projects expect profit margin exceeding 16%. The existing PPP models deny an opportunity of assured return for the growing number of retail investors belonging to the affluent and educated middle class by associating with infrastructure sector.

There is a growing awareness among investor community that infrastructure investment is safe and rewarding. This is important considering that even in poor economies pockets of affluence do exist holding considerable amount of funds an enabling environment prevents inflow of such funds towards productive and deserving arrears.

12. **Under utilization of management expertise.**

Inefficiency of public sector cannot be generalized. There are efficiently run public sector enterprises and departments which compete with the best in the world in their domain. The current PPP models do not have any avenue for utilizing such committed talents and their overall management skill. Similarly, there are efficient bureaucrats on whose abilities government and public at large have faith and respect. In the present scheme of things these talents go unutilized.

13. **Surreptitious promotion of privatization**

In the prevalent PPP models private sector is the real creator and provider of the service facility being the concessionaire and the ownership remains with public entity only on paper for all practical purposes . There is a growing tendency to idolize private sector though they are in the field more out of profit motive than on any social objective.

14. **Slowdown in economic growth and reluctance of private sector to invest**

PPP projects have been hit by a variety of factors such as the growth slowdown, the policy framework with regard to land acquisition and environmental issues, slow regulatory approvals (Lall, 2015). Indian economy cannot be said to have a steady high growth rate. Expecting private sector to be in the forefront of infrastructure revolution may be misplaced.

15. **Non-performing assets in infrastructure sector and financing of PPPs by banks in future.**

The four sectors of infrastructure namely iron and steel, textiles, aviation and mining accounted for 51% of total stressed assets (of the banks), with infrastructure alone accounting for about 30%[24]. The PPP projects in infrastructure are having a Debt Equity ratio of 30:70. Reluctance of banks to finance infrastructure projects is bound to adversely affect prospects of PPP.

6.1 Need for New Models

In infrastructure projects the many of the major risks namely identification of a technically suitable site, its appraisal, land acquisition, connectivity, safety and welfare of construction workers are addressed by government or government agencies. The major role of private sector is arranging funds and providing the management expertise. However most of the projects are having Debt Equity ratio of 70:30 implying huge dependency of PPP on banks. The liability of a non-performing PPP finally rests with the society at large. The profit maximization drive of private partner in the PPP can distort the risk projections and thus escalate the cost of service provided.

The issues highlighted above do throw light on the difficult terrains in which PPP is operating. While the fact that PPP is the most potent infrastructure development tool for India the conditions given above highlight the need for innovating new models which will broad base the concept even more. As infrastructure development is a compulsive requirement for the state government has to take the lead for investment and management control by developing a central core around which new flesh is built. The government may act as the central core and retail investors and small institutions can form the flesh around.

7. The Requisite Features of The New Model

1. The entity may be perceived as a government owned company by general public with Government is the major shareholder. Such a structure would help the entity to get a fair treatment from other interacting entities and government departments.

2. The entity need not have any dominating private entity imparting management expertise or holding management control. This will relieve the entity from the over ambitious drive for maximisation of profit.

3. The entity should be able to attract public investors to it in large numbers and they ought to receive good returns as dividend.

4. The firm can be constituted as per companies act and no separate legal frame work is necessary for it. It thus could save considerable expenditure incurred in conceiving and implementing complex PPP models.

5. The government directly or indirectly may stand as guarantee for all the major risks that need to be taken for the infrastructure development. This would result in incurring less cost on handling risks which enabled cheaper service provision.

6. The principle of 'allocation of risks to those who can manage them best' may be followed.

7. The firm can practice the concept of Value For Money while roping in the services experts in concerned functions either as consultants, contractors or employees to get the work done. It is in a position to deliver the services at convincing charges owing to this approach.

8. The firm should focus on establishing benchmarks in its social engagements as a pragmatic benefactor of the society.

9. The debt financing extended to the firm by banks to be repaid as per agreement. However, the opportunity for exchange of debts appropriately as the dividend may be explored.

10. The firm has to act as a responsible corporate citizen. It may organise and develop ancillary service provisions.

11. In an infrastructure project pursuing the above model, the ticklish issue of collecting user charges as return for investment easily gets sorted out as the project financing is done by public themselves.

    Research reveals that Cochin International Airport Ltd is a live model for the above practices and is acclaimed as a success story. Its success shatters the commonly held myths about inefficiency of government controls in running innovative organisations.

7.1 Features of CIAL Model

1. Government of Kerala holds 32.24% of the shares of CIAL. It is the single major shareholder of CIAL. The chairman of the board is Chief Minister of Government of Kerala. The director Board has 6 representatives of GOK. CIAL is perceived as a Government company by common public and has been able to garner public goodwill due to this reason.

2. CIAL does not have a dominating private entity blinded by greed. It is a profit making company driven by sound principles of corporate governance.

3. CIAL has been able to attract individual investors to it. 12.45 % of the total shares of CIAL is held by individual share holders and the participation of body corporate is limited to 5.0838 %. There is no dependence on any dominating private player for finances.
4. CIAL is constituted as per the Companies Act and no complex PPP contract procedures were required to be followed.
5. GOK has stood guarantee for all major risks that CIAL faced right from the time of its constitution.
6. Traditionally Kerala had a social and political climate favorable to public sector and CIAL has been able to tap it effectively.
7. CIAL follows an effective expert engagement strategy. It promotes talent and has been able to rope in innovative minds to design and work for the project. The Terminal complex was designed by KITCO, a Kerala Government owned consultancy firm.
8. The strategies adopted by CIAL in social engagements have been very effective in conflict resolution. The package offered by CIAL for land acquisition has been hailed by World Bank as a model for developing economies to follow.
9. The debt availed from banks has been adjusted as their shareholding. Banks have accepted the offer for equity as the consistently high dividend payout was higher than the earnings from interest.
10. CIAL has always acted as a responsible corporate citizen. It has major control in the functioning of CIAL taxi operators association which has exclusive rights for providing taxi services from the airport[31]. CIAL is ensuring that the services offered by CIAL taxi services are of commendable standards. CIAL has ventured into connected business in a big way making profits in those areas with positive social impact. It is the first airport in the world to meet all its energy needs exclusively from solar power.
11. CIAL does not collect user fee from passengers.

8. Conclusion

PPP models currently in vogue in India have lost their sheen.

There is a need to develop new models to meet the emerging public mood and expectations. It also should be able to tap the funds with the growing middle class. Government does have capable hands with in it who can be assigned the task of structuring and operating firms funded by direct public investments, and government investments, in which government shall have majority stake. It will ensure that government shall possess the management control of the firm. In other words infrastructure projects with transparent scheme and assured returns can attract public savings once government is able to put in place credible management teams for operationalizing return. Government thus can earn accolades from public for providing them world-class infrastructure services on the one hand, making them richer in the process on the other. The hidden potential of an alternative PPP model to wade through a troubled economic environment may be understood by the policy makers from the success of Cochin International Airport Limited.

References

http:// www.livemint.com/Sundayapp/Tlkphu70hpPwV6QifPxbjO/ The dangers of relying on PPP.html.

The report of the committee on revisiting and revitalising public private partnership model of infrastructure, Nov 2015

The report of the committee on revisiting and revitalising public private partnership model of infrastructure, Nov 2015

U.S. Department of Transportation, Private Sector Involvement in Urban Transportation, Washington, DC: Federal Highway Administration, 1986.

United Kingdom-England PPP Units and Related Institutional Framework, European PPP Expertise Centre, June 2012

Public-Private Partnerships, REFERENCE GUIDE VERSION 2.0, WORLD BAN GROUP.

Public-private partnerships: The US perspective, PWC, June 2010

Guidelines for successful public - private partnerships European commission, directorate-general regional policy, 2003

Public private partnership Handbook – Asian Development Bank http://www.pppinindia.com

PPPs website maintained by the DEA, Ministry of Finance

Working subgroup on infrastructure- Infrastructure funding requirements and its sources over the implementation period of the twelfth 5 year plan. Planning commission Of India

How to attain value for money – comparing PPP and traditional infrastructure public procurement – Philip burger OECD journal on budgeting volume 2011/1

Philip burger, How to attain value for money – comparing PPP and traditional infrastructure public procurement , OECD journal on budgeting volume, 2011/1

Public Private Partnership, Garima Wahi Yojana, Nov 2013

PPP in Infrastructure projects – Public Auditing Guidelines CAG of India 2009.

Exclusive - Govt to revamp PPP model to speed up infra projects, Bloomberg TV website,

http://www.btvin.com/article/read/news/1643/exclusive---govt-to-revamp-ppp-model-to-speed-up-infra-projects, accessed 13 August 2015

India PPP Summit 2015 – Restoring the momentum and reviving PPPs in India –FICCI

India PPP Summit 2015 – Restoring the momentum and reviving PPPs in India –FICCI

Rakesh Mohan, Muneesh Kapur, Pressing the Indian Growth Accelerator: Policy Imperatives , IMF Working paper 69, 2015

PPP in Infrastructure projects – Public Auditing Guidelines, CAG of India, 2009.

Ehtisham Ahmad, Involving the Private Sector and PPPs in Financing Public Investments: Some opportunities and challenges- Asia Research Centre working paper 67-

Clive Harris, Kumar Tadimalla, Financing the boom in public-private partnerships in Indian infrastructure - Trends and policy implications, GRIDLINES Note No 45, Dec 2008

Lall, Rajiv, "Turn the PPP Model on Its Head", Business Standard, January 3, 2015.

Harshavardhan Neotia

Getting out of the NPA mess, Updated: Financial Express

March 29, 2016

Case Studies ; http://www. cial.aero

CIAL Annual report 2014-2015

Mohan B, and P. Filomina (2015) "Airport Solarisation – CIAL steals the thunder;" Case Studies ; http://www. cial.aero

Ramesan P, and S. Jeyavelu (2007) V.J.Kurian & the CIAL saga; IIM Kozhikode, Case Studies ; http://www. cial.aero

cial.aero/contents/viewcontent.aspx?linkid=51

Ramesan P., and S. Jeyavelu (2007) V.J.Kurian & the CIAL saga; IIM Kozhikode, Case Studies ; http://www. cial.aero

Cial.aero/userFiles/CIALwebsite/cial_whitepaper3.pdf

****