

# Public Private Partnerships: the way forward for major projects?

KPMG INTERNATIONAL

Governments across the globe are increasingly turning to partnerships with the private sector as a means of delivering improvements in infrastructure and public services. Under these arrangements, private sector business acumen can be applied to collaborative public sector projects.

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Through Public Private Partnerships (PPPs), the private sector manages the design, build, finance and operation of assets and services traditionally procured by government and funded by taxpayers.

A recent report by KPMG's global government practice and the Economist Intelligence Unit confirmed the growing popularity of these schemes among senior government executives to finance projects more effectively.

PPPs are prevalent in sectors such as:

- Transport – roads (including road pricing), rail, metros, airports and ports
- Energy and natural resources – nuclear, renewables, waste, water, oil and gas, mining
- Social – health, education, local government facilities and prisons
- Defence – training, facilities and equipment
- Technology – equipment, software and services.

## What is driving PPP?

The growing popularity of PPP projects can be ascribed to global economic, market and investment trends.

**Economic** At the macro level, populations are growing (and ageing) fast and are demanding better public services, without higher taxes. In many developing countries, infrastructure is the biggest single factor holding back economic growth; in wealthy nations, infrastructure often suffers from decades of under-investment and needs replacing. Booz Allen Hamilton estimates that modernizing the water, electricity and transportation systems of major cities will require approximately US\$40 trillion over the next 25 years. Similarly, the OECD estimates that spending on infrastructure around the world needs to exceed \$2 trillion annually if we are to maintain economic growth. Given the huge costs and complexity of infrastructure projects, there is an obvious gap for the private sector to step in.

**Market** In the past 15 years commercial models have evolved to bring in private sector expertise. These go beyond the financing of projects to the allocation of services to private firms through competitive bidding. Legal and commercial frameworks have been developed and have reached a stage of maturity in many countries. Gradually, a global industry has become established which is focused on the delivery of public services and infrastructure as a market. With this, public acceptance of private sector involvement in public services is growing.

**Investment** Infrastructure has emerged in recent years as a popular alternative investment class, offering diversification to investors. Pension funds are attracted to the long-term, predictable, inflation-linked income potential of infrastructure.

## The challenges

As a pioneer of PPP schemes worldwide, KPMG has gained in-depth understanding of the immense potential of these projects. In the UK, a census of PPP projects by the National Audit Office (2003) found that of the 37 projects surveyed, 29 were delivering price certainty and resulted in no construction-related price increases to the government after contract award. This is a dramatic improvement compared with a previous survey of public building projects in 1999 which found that 73 percent had overshot the cost expected by the public sector.

As an advisor to government in the creation of PPPs, our professionals frequently encounter the following issues.

**Procurement expertise** Expertise is variable within the public sector. PPPs are complex transactions and, often, project teams may lack specialist experience and can be subject to regular job rotation. This can automatically put the public sector at a disadvantage in negotiations with potential partners who have considerable global experience.

**Public opinion** While those within government with experience of PPP have often seen enough to be convinced of their value, the electorate still needs to be won over, mainly via the media. Private sector involvement in public services remains an ideological battlefield. But because of their complexity, the projects are by nature not “media-friendly.” The ins and outs are often difficult to explain and do not spark immediate public interest. What’s more, there is a lack of individuals who both understand PPP and are able to distil the facts and present their case. This leads to simplistic media coverage, with an emphasis on market “failures” and little coverage of successful, day-to-day delivery.

**Political will** Infrastructure projects, by their very nature, operate over an extremely long time frame, while political decisions are often subject to shorter-term considerations. Political will to drive through PPPs, and to avoid the urge to “tinker”, is vital. Public sector officials need to understand that, in a global market, if countries do not demonstrate this will clearly, private sector operators will simply divert key resources elsewhere.

**Thinking through objectives** When planning major projects, the decisions taken at the very earliest stages will have long term financial, legal and technical consequences, which can be the root of subsequent delays and overruns. It is vital, therefore, that public sector officials, who may be new in role, appreciate the importance of having experienced advisors in the room, who can spot potential pitfalls that may lie ahead. Because of the financial disciplines that PPPs impose, much more thought is given to project objectives, and their consequences, than may be typical on other projects. This “whole life” approach to planning is key to obtaining value for money in the long term.

**Making a partnership happen** In a PPP, it is important that the parties involved understand their differing objectives – political and economic – and priorities. A PPP has to find the ground upon which both parties feel they can succeed and meet these objectives. Such discussions often evolve against the backdrop of strict procurement guidelines. Thus, it is critical that both parties understand the mindset and language of the other.

## What KPMG can bring

Our depth of experience of PPP means we can harmonize conflict and support governments in overcoming the challenges – translating into success for both parties. We believe our understanding is unrivalled on a global scale and that we are in a position to assist on any major infrastructure transaction.

**Global reach** KPMG firms are able to bring to bear their experience of multiple global markets – with infrastructure experience in over 80 countries. Our business is well balanced between public and private sectors so we can identify issues and strategies from both sides. This allows us to act as the bridge when government and private sector teams sit down together.

We can do the translating, drawing on the knowledge of staff whose previous careers span investment banking, government and an array of specialist areas including transport, defense, energy (from renewable to nuclear) highways, metros – even theme parks. Our firms have more than 300 staff worldwide focused on this market in corporate finance alone.

We can demonstrate how we have tackled and overcome most of the issues that arise in this arena. We are willing to embrace even the largest projects: KPMG is advising on the US State of Texas' \$186 billion toll road, one of the largest projects ever procured. Our appointment was based on our extensive experience gained on road projects around the world.

**Ability to handle complexity and size** PPPs are complex to structure because of their size and the long-term risks involved. They demand, therefore, a range of advisory services, including strategic consulting financial analysis, liaison with investors, financial modeling, procurement advice, fairness audits and risk valuation as well as clarifying tax implications, debt-structuring and other factors.

KPMG firms are presently playing a key role in several high-profile projects such as the UK's "Building Schools for the Future" – a scheme to rebuild or renew every secondary school in England over a 10 to 15 year period – and Germany's first PPP road project. It helps that our firms' staff also include many former high-ranking government officials, who bring their wealth of knowledge and experience.

**Track record** KPMG firms have been involved with PPP from the start. We have pioneered projects in healthcare, defense, education, energy and transport and have produced new generations of PPP models. We have been consistent in helping ensure projects are completed on time and to budget, and delivered to a specified level. To date we have advised on more than 800 projects worldwide and received many industry awards including *Infrastructure Journal's* Global Financial Advisor of the Year and PPP Advisor of the Year for 2007.

## The road ahead

Despite some fairly fundamental differences in the core objectives of public and private sector organizations, recent years have seen significant improvements in structuring and managing large scale infrastructure partnerships. If there is one overall lesson it is that when care and effort is taken to align objectives – true partnership can be achieved, and can be achieved successfully.

Performance agenda: an international government survey, carried out by KPMG and the Economist Intelligence Unit, June 2007. *Lights! Water! Motion!* (Strategy and Business); Issue 46, spring 2007.

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Based on a major international survey and in-depth interviews with public sector executives, this KPMG International report looks at how governments are working to improve their operational efficiency.



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### Building for Prosperity: exploring the prospects or Public Private Partnerships in Asia Pacific

The concept of contracting under long-term arrangements such as PPP or PFI is quite new in many parts of Asia. This report examines the experience of the UK, Australia and Singapore and explores the possibility of using the PPP model to support infrastructure growth throughout Asia Pacific.

For copies of these publications, please contact your local KPMG representative.

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