



State Planning Retreat on Public Private Partnerships - Illinois

Building PPP capabilities

Discussion document

June 10, 2014

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A fresh approach to deliver PPP performance

1 PPPs face a unique set of challenges: the growing **need for PPPs**, even though many PPPs have **not delivered** on all **expected benefits**

2 Focusing on the **PPP unit** performance, not the PPPs themselves, has shown that governments can achieve 10-20% **value enhancement of PPPs**, enhanced **risk allocation**, ~50% compression of **time to completion** and **increased capacity** for deal execution in the PPP unit of 50-70%

3 There are 4 key levers to achieving these results: a) a **revamped end-to-end process** supported by b) a **suite of analytic and decision making tools and templates** c) executed through a **PPP control tower**, and d) enabled by **capability building** and **PPP stakeholders management**

4 This requires PPP units to embark on a **performance transformation journey**, that combines **institutionalization of tools, processes and capabilities** with **immediate delivery** of high-value PPPs

5 Example case studies from our client work transforming PPP delivery units



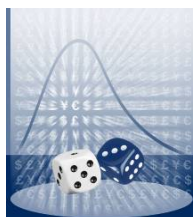
1

If done well, PPPs deliver four fundamental benefits to generate significant value for money



Increased efficiency

- Private sector has **financial interest** to deliver on time
- **Optimise life-cycle cost** (investment vs. ops cost)
- **Meet budgets** (known outputs for known cost)
- **Competition** between bidders drive price down



Appropriate risk allocation

- **Risk allocated** to party best able to manage it
- **Risk reduction** by redefining relationship between parties
- Maintains **quality** of service through effective incentive system



Leverage private sector strengths

- Maximised use of **private sector skill**
- **Execution and delivery expertise**



New sources of financing

- Injection of **private capital** and ability to raise additional capital
- Makes projects **affordable** if borrowing is limited
- Project can be funded **off-balance sheet**¹

¹ Off-balance sheet treatment rules are changing in many countries as this treatment is often thought to have political rather than economic value

Despite an intense focus on PPP transactions, major PPP challenges continue to make the headlines

China Audit Finds \$900M in Misused Funds

Metronet fails PPP Arbiter assessment

16 November 2006

BETUWE LINE: NO FLYING START FOR ROTTERDAM-GERMANY FREIGHT LINK

'Neighbours' needn't fear the noise for time being

06-07-2007

Creditors refuse to agree

Shock: Sale of Bratislava Airport to Vienna Cancelled

Eurotunnel debt write-off

The Sydney Morning Herald

German Government Cancels Toll Contract

For sale: ghost train to Sydney Airport



The Cross City Tunnel scandal should lead to public scrutiny of private infrastructure deals, writes

It was supposed to be Europe's most advanced toll system, now it's Germany's biggest embarrassment.

INTERNATIONAL Herald Tribune

PM pulls out of BIAL launch

Jinx on Bangalore Airport continues

\$14.6 billion later, Boston's Big Dig wraps up

The last big highway section opens this weekend, but concerns on costs dampen party.

Delay in Hassan-Mangalore gauge conversion

Eurotunnel Gives Up Trying To Forecast an Opening Date

A fresh approach is needed!!!!

1

While most people focus on transaction specific results, we focus on achieving ...

“Faster, Better, More PPPs by ...

- **Focusing on capabilities and processes** of the PPP unit itself
 - Building these capabilities and redesigning the PPP process through **live transactions**
-

2

By focusing on the PPP unit and not just the PPP deals, faster, better and more PPPs can be delivered



***F**ASTER **PPP**_s*

- ... through a **rapid** and **simple process** standardized across all PPP deals to ensure that all deals get done **quickly** and **accurately**

Typical impact

Reduce
time by
50%



***B**ETTER **PPP**_s*

- ... through PPP structures that ensure **optimal allocation** of deal roles, **risks** and **responsibilities** between public and private sector

Increase
value by
10-20%



***M**ORE **PPP**_s*

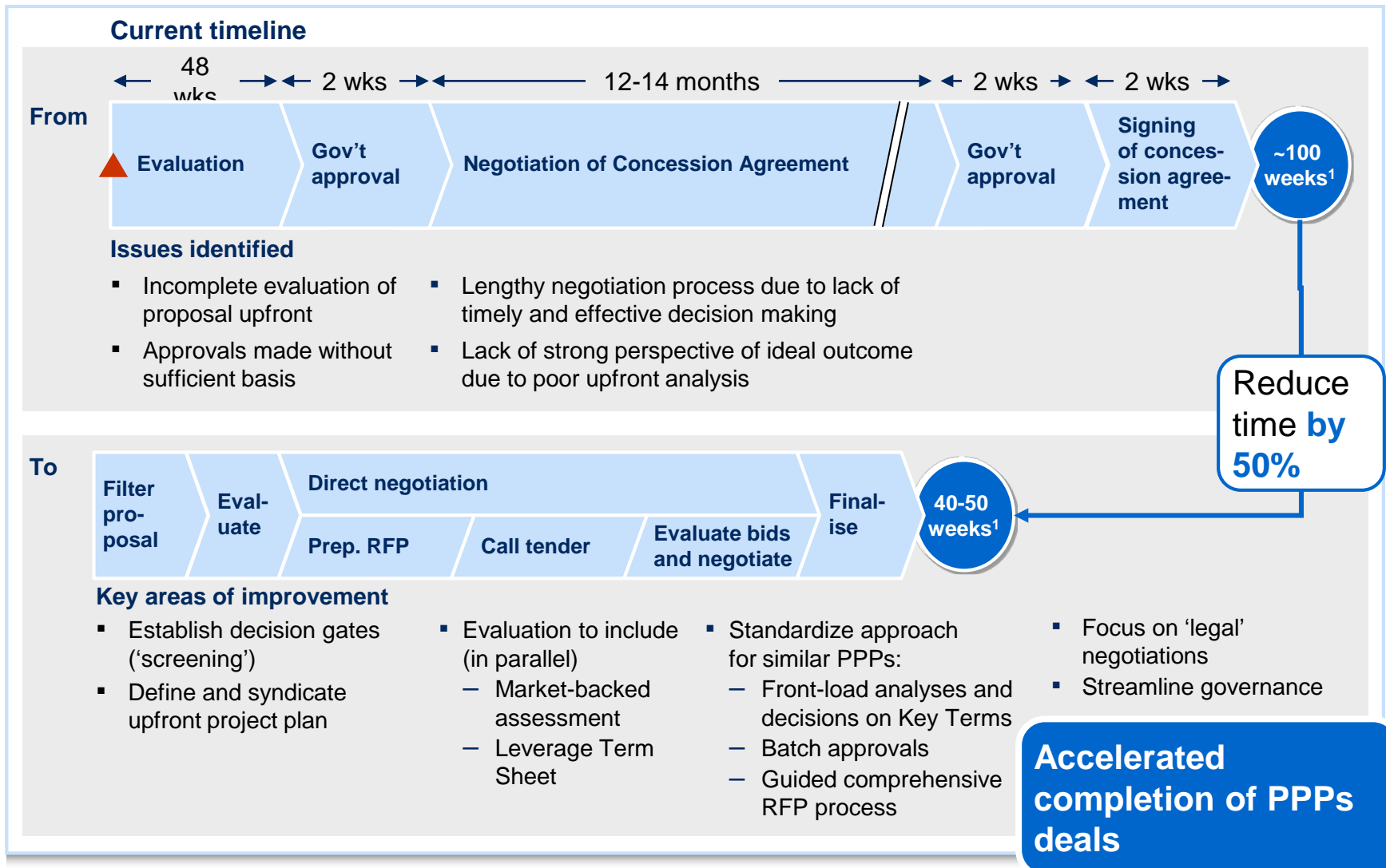
- Execute a **greater number** of PPP transactions to **increase** the **quantum of private investment**

Increase
capacity by
70%

2

Faster: Implement a new standardized rapid process to accelerate deals by approximately 50%, enabling PPP to deliver their expected impact early

DISGUISED CLIENT EXAMPLE

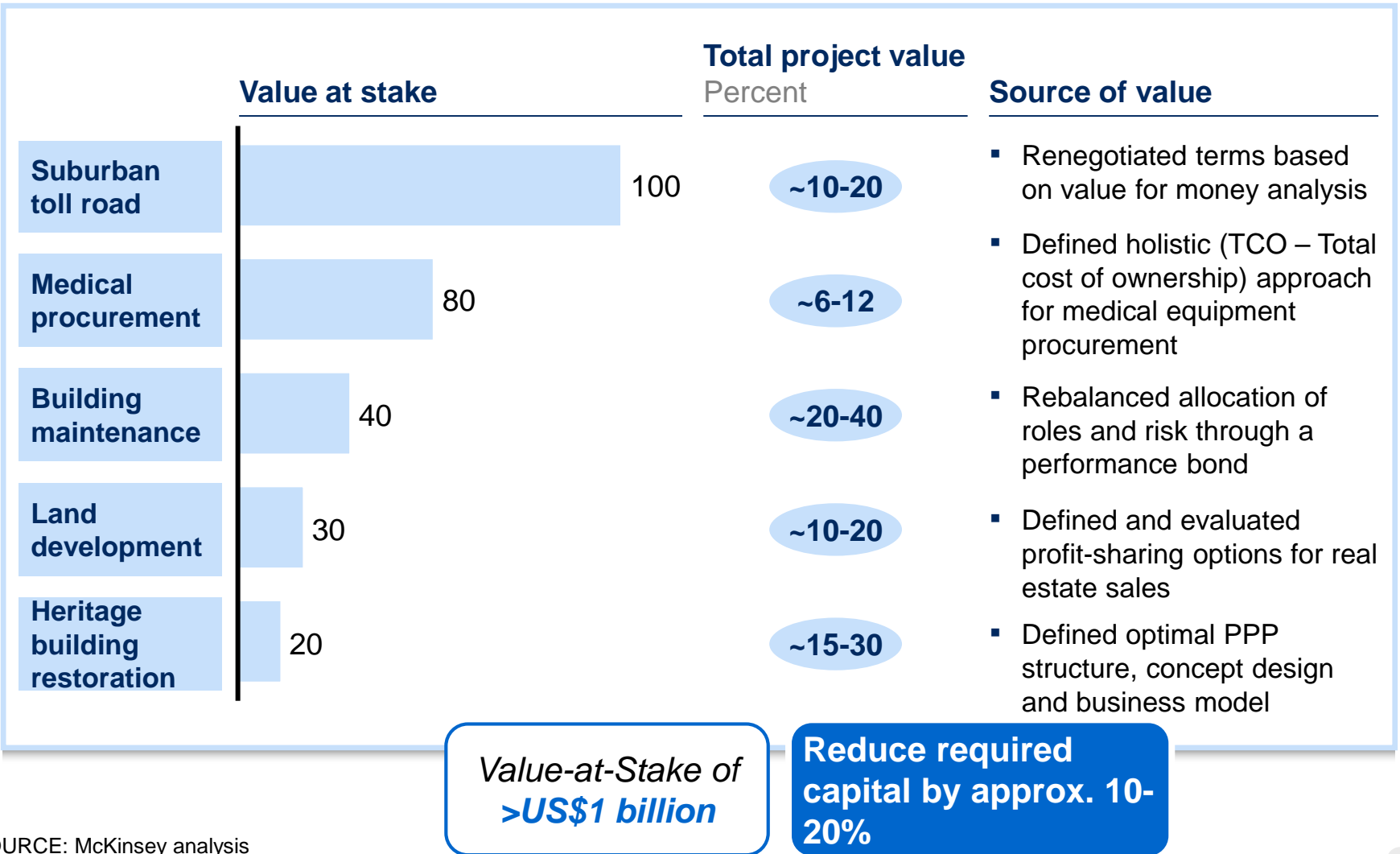


2

Better: The approach consistently identifies average savings of ~10-20% of the total value of PPPs in wide range of sectors

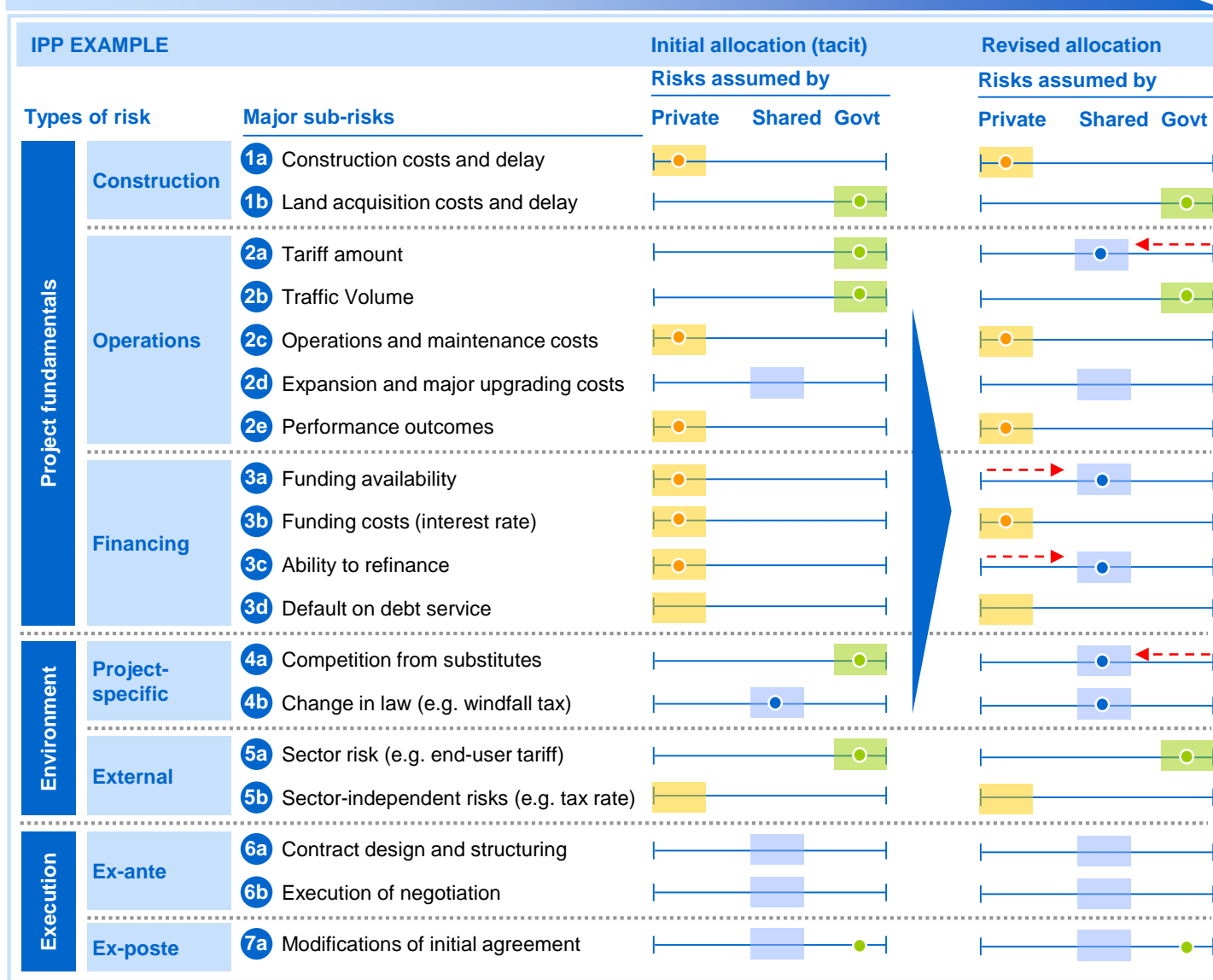
Local currency, indexed

DISGUISED CLIENT EXAMPLE



Better: the approach systematically identifies key PPP risks and optimally re-allocates them to the public and private sector

DISGUISED
PPP EXAMPLE



Impact

- Increased emphasis on **upfront capital expenditure optimization** through proactive value management of construction
- Greater private sector **accountability for performance** with tariffs linked to operational performance standards

2

More: Discipline of action is needed to ensure institutionalization, which can result in an increase in capacity by up to 70%

From

To

Pipeline capacity

Increase capacity by **by 70%**

50 deals per year

85 deals per year

Resources required per deal

- | | |
|--|---|
| <ul style="list-style-type: none"> ▪ ~100 weeks ▪ 2 investment officers ▪ Undefined number of management meetings | <ul style="list-style-type: none"> ▪ ~50 weeks ▪ 2 investment officers ▪ 5-7 leadership management meetings at predefined decision gates |
|--|---|

Resources available

- | | |
|---|---|
| <ul style="list-style-type: none"> ▪ 50 investment officers ▪ Limited leadership time | <ul style="list-style-type: none"> ▪ 50 investment officers ▪ Limited leadership time |
|---|---|

Achieved through..

- Standardized analysis and decision making process
- Key performance indicators to track implementation progress
- Clearly defined decision gates
- Weekly decision oriented action meetings

Attract approx. 70% more private investments annually

3

The end-to-end process driven transformation is a four-pronged approach to transition PPP units to a higher level of performance ...

Description

A

Introduce **new end-to-end PPP process** from origination to closing

Filter proposal

Eval-
uate

Direct negotiation

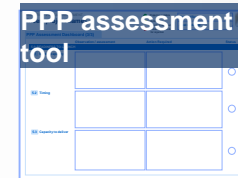
Prep. RFP

Call tender

Evaluate bids
and negotiateFinal-
ise40-50
weeks¹

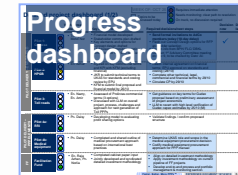
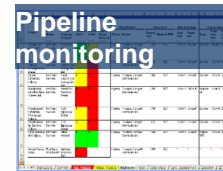
B

Introduce entire suite of **standardized tools and analytics** to support best-in-class infrastructure deals



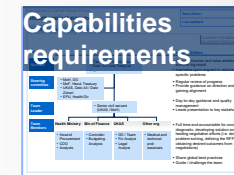
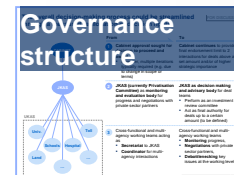
C

Run a **full-time “PPP control tower”** with weekly rhythm to monitor and debottleneck priority PPP projects



D

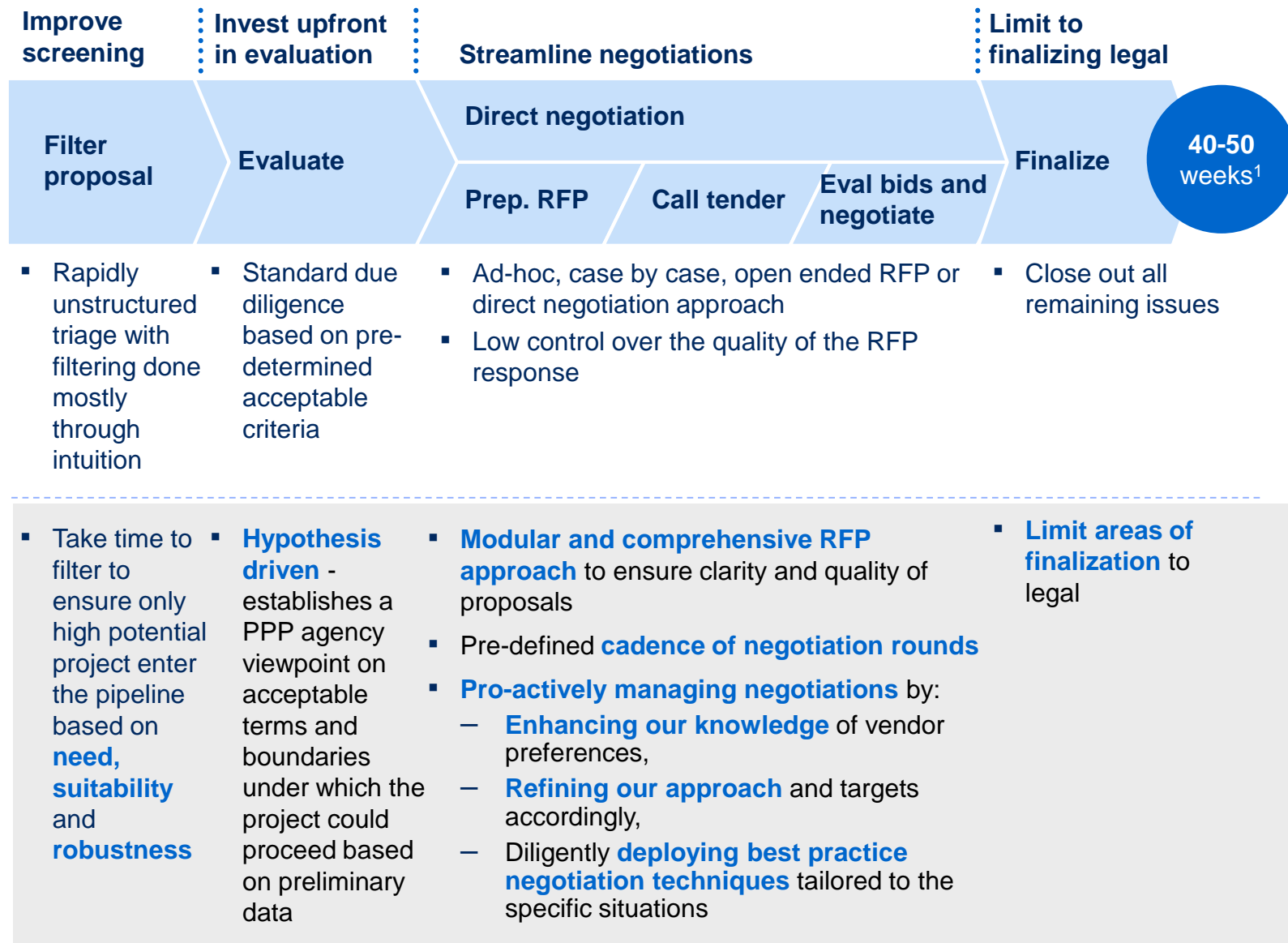
Establish proper **governance and capabilities** as enablers not drivers



FASTER, BETTER, MORE PPPs



Adopt a new end-to-end standardized deal process from origination to closing

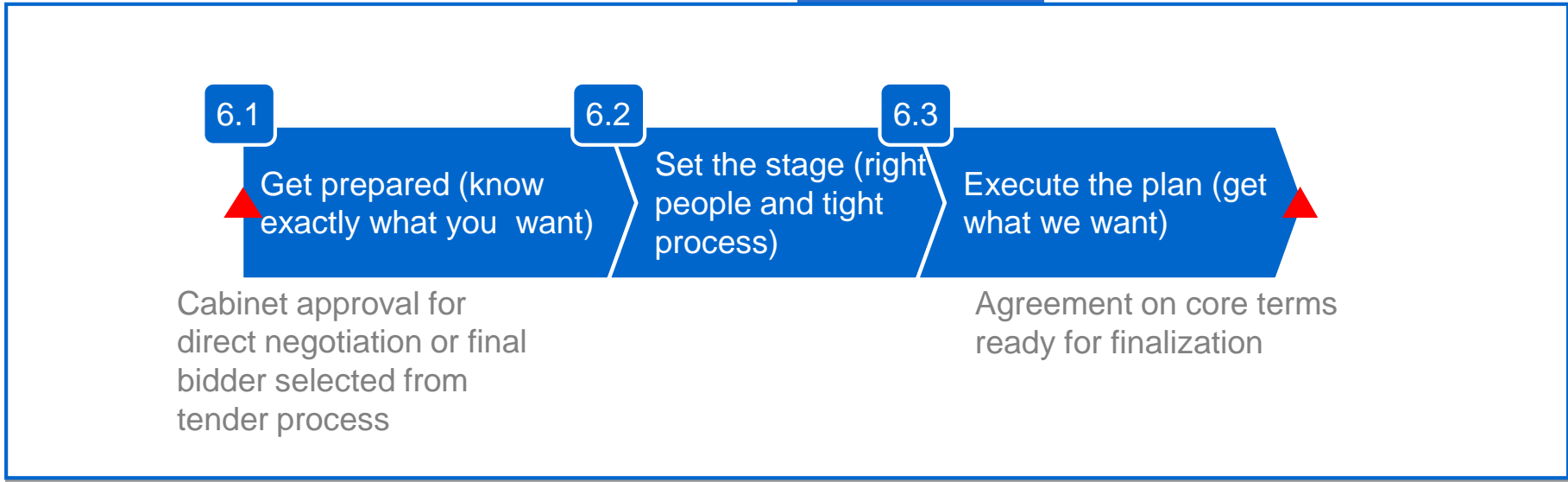


Negotiate: Start with an ideal and end up with a deal

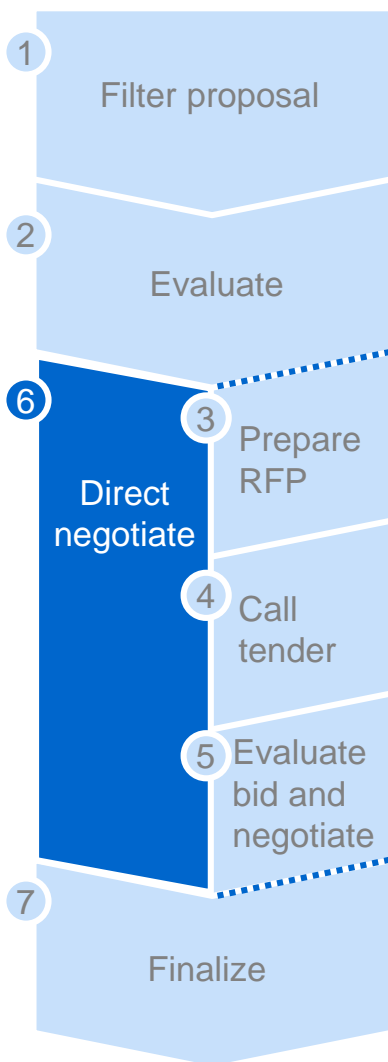


- **MDO** Most desirable outcome
- **BATNA** Best alternative to negotiated agreement

End-to-end deal process: Direct negotiation



A distinctive negotiation process requires effective preparation and diligent execution to obtain the MDO



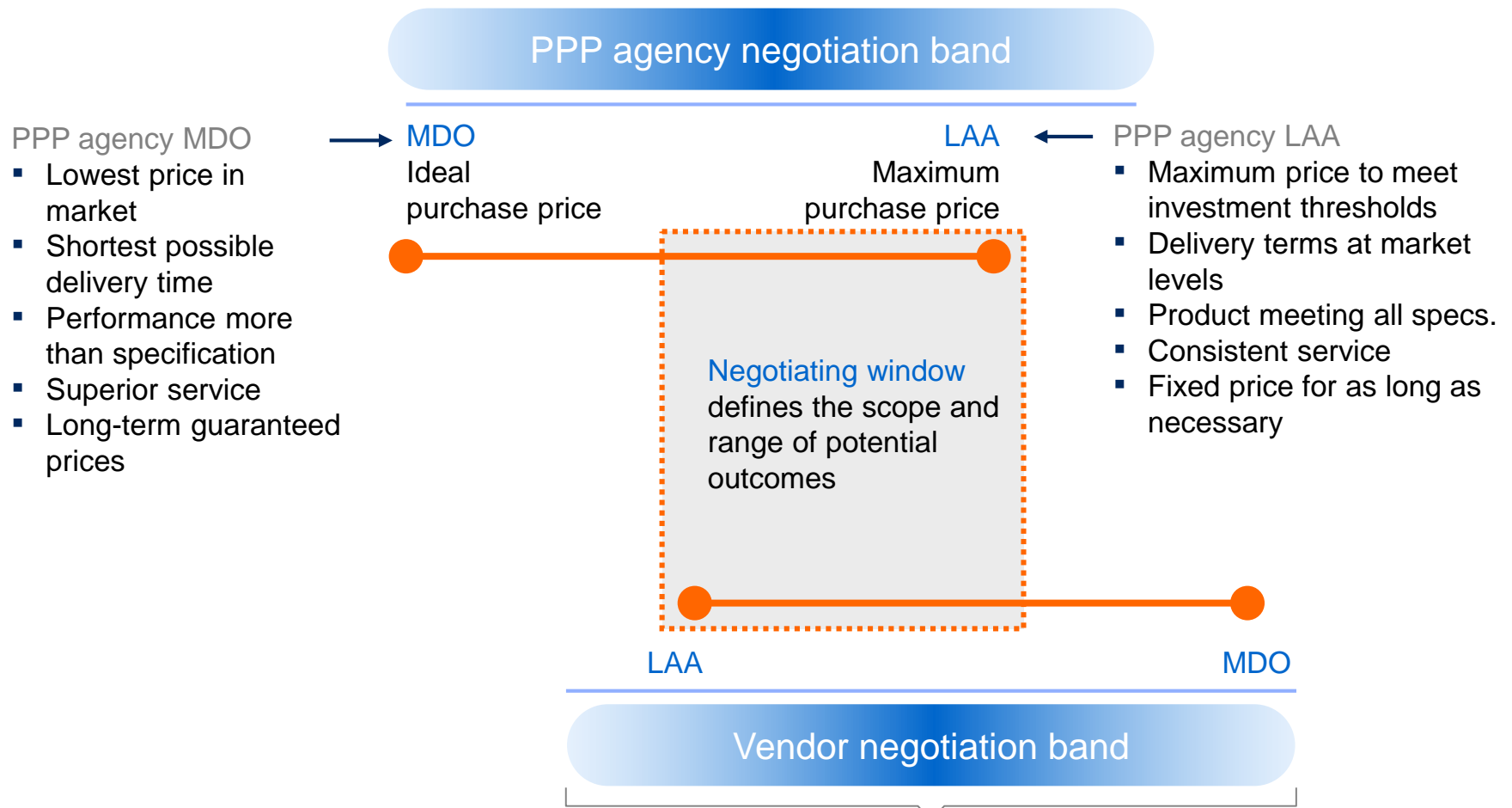
What makes a negotiation process distinctive?

- Precisely articulating **preferred outcomes** prior to commencement of negotiation:
 - **What we want** (MDO and LAA – least acceptable agreement)
 - **What our walk-away position is** (BATNA)
 - What counterparty is likely to want or is willing to trade-off
- **Fully aligned PPP agency team** that **deploys most skilled negotiators** with **specific roles, messages to communicate, and outcomes to obtain** in each negotiation round
- Predefined **cadence of negotiation rounds** that allow PPP agency to build on **intermediate milestones** to achieve our **end goal** (MDO)
- **Proactively managing actual negotiations** by:
 - **Enhancing our knowledge** of vendor preferences
 - **Refining our approach** and targets accordingly
 - Diligently **deploying best-practice negotiation techniques** tailored to the specific situations

Success in negotiation extends beyond the actual discussion and requires:

- Extensive preparation and planning
- Diligent execution to reach our goal

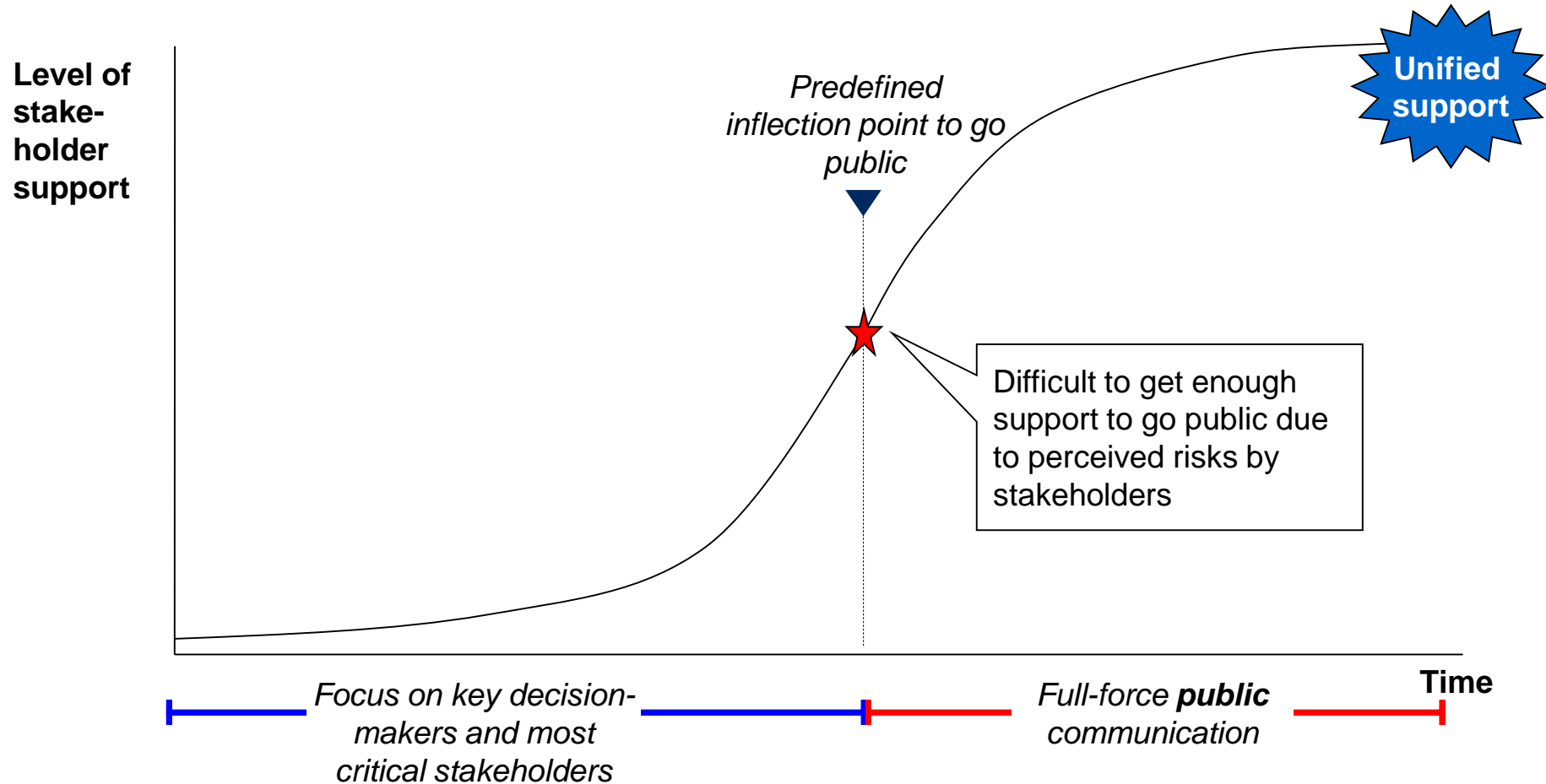
Key terms for each negotiation lever should be assessed



To fully prepare for negotiations, we need to ascertain vendor's positions

- Allows to determine range of likely outcomes
- Allows to ascertain vendor's preferences and likely trade-offs

Sequence communications to build crescendo of support



Focus:

Key is risk-free consultation

- First have private meetings with **supportive stakeholders** that are easy to win over
- Once there is wide enough support, privately meet the more **difficult stakeholders**

Ride on momentum by going public

- Prepare messages for clients and supportive stakeholders to issue to media
- Orchestrate prominent opinion shapers to make public statements



Introduce an entire suite of standardized tools and analytics to support best-in-class infrastructure deals

EVALUATE EXAMPLE

NOT EXHAUSTIVE

Filter

Evaluate

Direct negotiation

Prepare RFP

Call tender

Evaluate bids

Finalize

Roles and Risk allocation tool

EVALUATION: 2.2 DEAL ASSESSMENT

<Insert project name>

Desk officer:

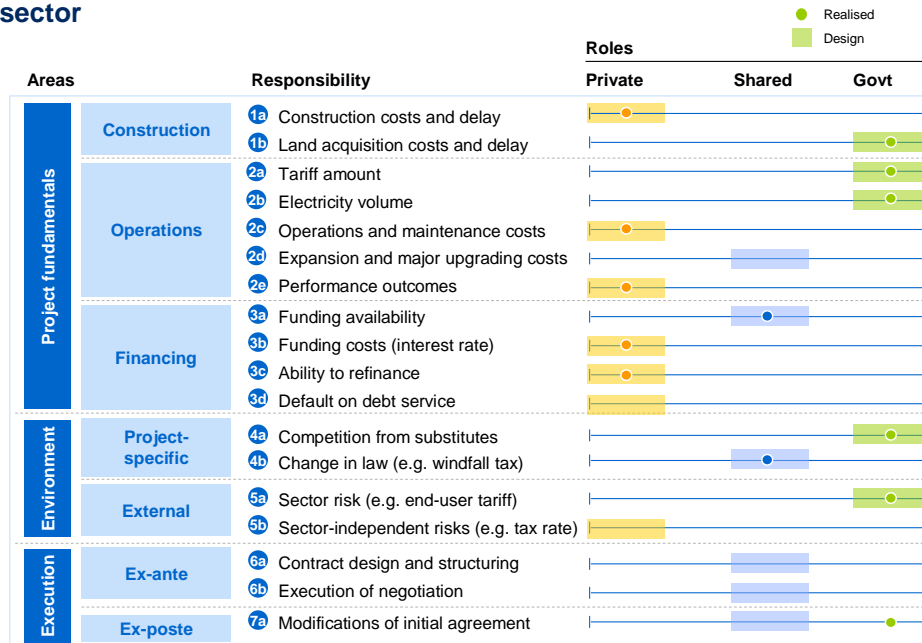


EVALUATION: 2.2 DEAL ASSESSMENT



2.2 Guidance on potential PPP role and risk allocation and potential

Clearly allocated and delineated roles and risks across public/private sector



SOURCE: Team analysis

11



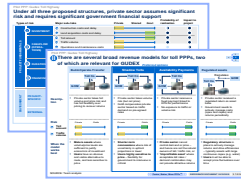
PPP “control tower” is leveraged as management tool to ensure best practice delivery of pilot PPPs and institutionalization across the PPP unit

PPP control tower launched

- Complete diagnosis
- Select pilot deals
- Team kick off

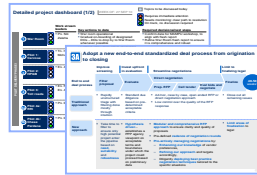
Complete key analyses

- Value for money comparator
- Needs analysis
- Risk & role allocation



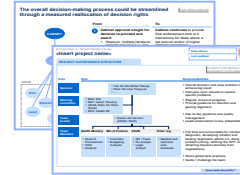
Debottleneck process issues

- Stakeholder management
- Approvals and syndication



Make key decisions

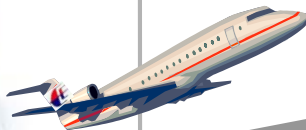
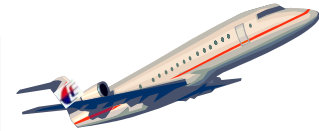
- Technical specifications
- Term sheet
- Approach to award
- Detailed terms



Pilot PPPs delivered with model for replication

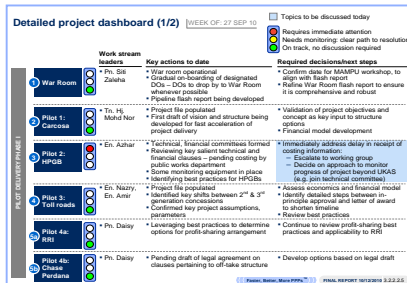
- Increase value by 10-20%
- Reduce time by 50%
- Increase capacity by 70%

Pilot PPP delivery

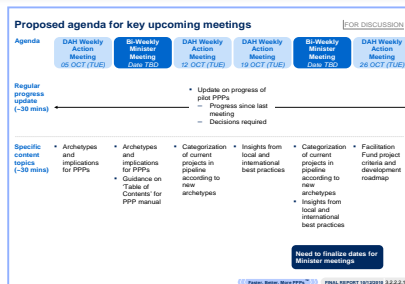


Run a full-time “PPP control tower” with weekly rhythm to monitor and debottleneck priority PPP projects

Visual management



Weekly decision meetings



Objectives of today's discussion

Overall project and priority update	GUIDEX: Decision on preferred options to improve project economics	15 mins	<input type="checkbox"/>
	Facilitation Fund: Agree decisions across structuring approach and discuss implications on current pipeline	10 mins	<input type="checkbox"/>
	Caracota: Validate business model, tender structure and key terms for RFP	10 mins	<input type="checkbox"/>
	RRI: Validate proposed profit sharing structure	5 mins	<input type="checkbox"/>
	HPDB: Share negotiation approach and endorse cabinet submission timeline	5 mins	<input type="checkbox"/>
UKAS Transformation	Gallery Walk – Introduce new War Room format for pipeline monitoring – Experience end-to-end process	10 mins	<input type="checkbox"/>
	Discuss immediate next steps and proposed agenda for upcoming meetings	5 mins	<input type="checkbox"/>
Next steps		5 mins	<input type="checkbox"/>

[[PHASE: War Room/PPPs]] PHASE REPORT VERSION: 3.2.2.15

Pipeline monitoring tool

Project	DC in phase	Phase Change	Previous status	Current status	Classification	Next steps	Lead	Report end	High	Low	High	Low
Caracota	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Farafra	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1
Jeddah	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1	Phase 1

[[PHASE: War Room/PPPs]] PHASE REPORT VERSION: 3.2.2.15



- Extensive use of gallery walk style presentation to bring the process alive
- Wall displays of pipeline status to increase transparency and highlight critical bottlenecks

Increase transparency

- Weekly action meetings with key leadership to
 - Debottleneck pipeline issues
 - Share learnings across different projects

Ensure greater precision

- Excel based tool to facilitate pipeline monitoring and data collection
- Pipeline flash report to highlight key issues and next steps

Accelerate pace of execution

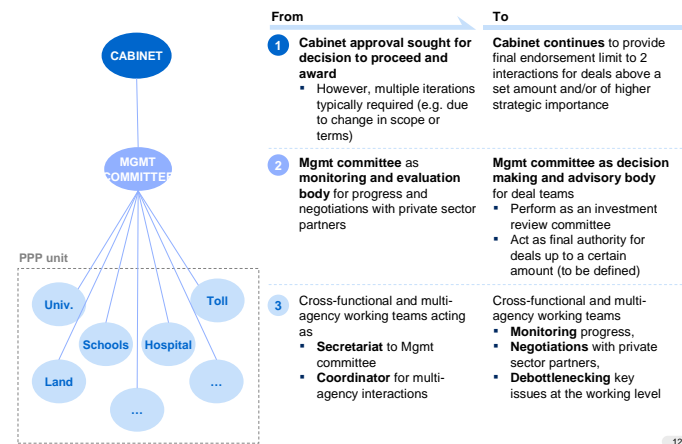


Establish proper governance and capabilities to replicate performance across all PPPs

Clear decision making structures must be put in place

The overall decision-making process could be streamlined through a measured reallocation of decision rights

ILLUSTRATION



Required capabilities at each level of organization will be identified

EVALUATION: 2.1 SETUP PROJECT PLAN

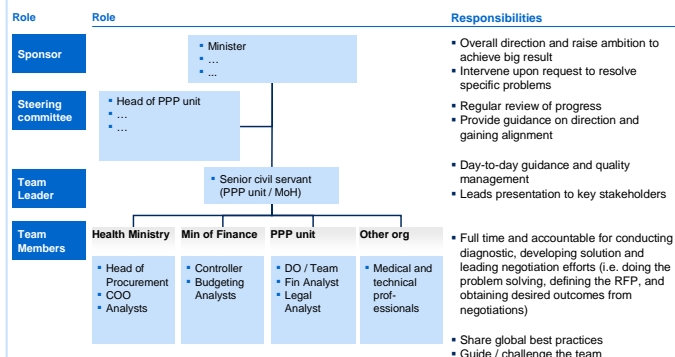
<Insert project name>

Desk officer:
Last updated:



PROJECT GOVERNANCE STRUCTURE

EXAMPLE FOR MEDICAL EQUIPMENT PROCUREMENT



Faster, Better, More PPPs™ 8

Traditional approach

- Decision makers drive the progress of the deal

New approach

- Decision makers enable the progress of the deal driven by the investment officer and the private sector
- Capabilities limited to those available within the existing PPP unit
- Experts from other agencies leveraged extensively to ensure cross functional capabilities are brought into every deal

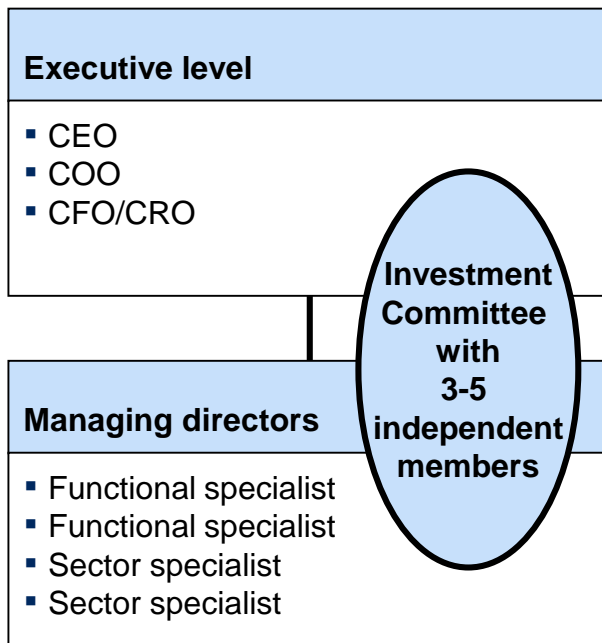


Client example: PPP center of excellence organizational structure

DISGUISED CLIENT EXAMPLE

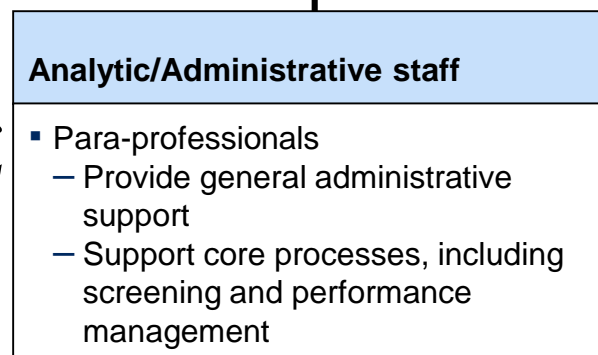
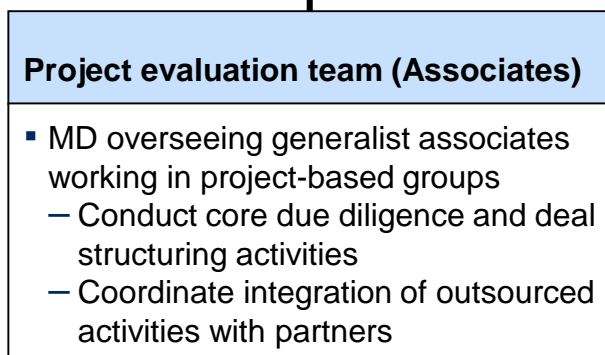
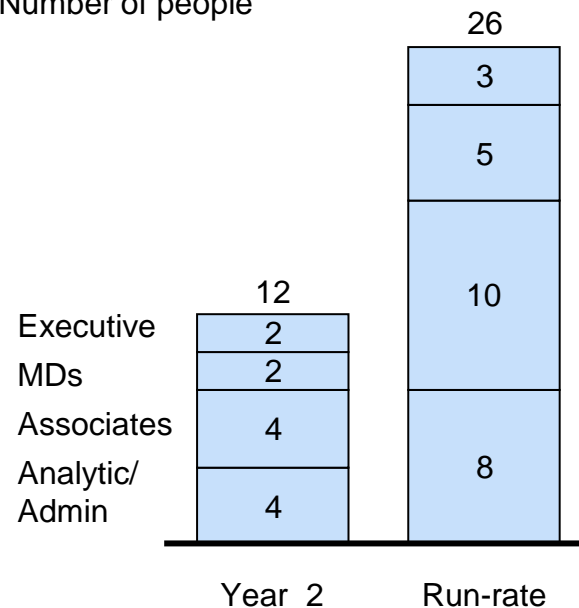
Leadership responsibilities

- Meet regularly to review proposed deals
 - MD champion presents each project
 - Executive leadership provide coverage across all functions and sectors
- Generate deal flow
- Lead deal evaluation teams
 - Guide and stress test deal team analysis
 - Manage key relationships through deal development
- Generate deal flow



Investment fund staffing levels

Number of people



4

Your transformation journey can take place over three modules

End products of joint team

Module 1 – Diagnosis

- Understand the existing end to end deal process
- Assess the structure and analyses of current transactions
- Conduct stocktake of existing pipeline and origination capability
- Understand existing capabilities, decision rights and governance structure

Module 2a - PPP Institutionalization

- Customization of standard process to specific PPP unit and environment to ensure adoption

Module 2b – PPP Delivery

- Use PPP control tower approach on a few selected “pilot” projects
- Apply standard process and tools and analytics to the pilot projects

Module 3 - Replication

- Replicating the standard process, tools and analytics and decision making across all deals in the pipeline
- Ensuring the right capabilities and governance structure is in place for full replication

Direct benefits

- Ensures key issues are identified
- Facilitates prioritization to focus on most critical issue

- Simultaneous institutionalize best practices and deliver rapidly deliver impact through acceleration of high value deals accelerated through the PPP control tower

- Ensures transformation takes place across the entire unit

McKinsey has developed deep experience in working with governments to establish and transform PPP units

Sample situations	Impact
<p>1 Asian govt PPP unit</p> <p>Government needed to transform existing standalone PPP unit to a driver of PPPs with world class capabilities</p>	<ul style="list-style-type: none"> ▪ Achieved 10-20% increase in value in pilot projects across various sectors (over USD1bil value at stake) ▪ Transformed PPP unit into key catalyst of for mobilization of private investment ▪ Created a replicable model for structuring toll roads
<p>2 European govt PPP unit</p> <p>Govt needed to rapidly develop PPP capabilities to meet massive need for infrastructure investments</p>	<ul style="list-style-type: none"> ▪ Established self sustaining PPP Unit with central coordination role ▪ Developed PPP standards ▪ Received high level of political and media receptiveness
<p>3 Canadian PPP unit</p> <p>PPP Authority needed to define its role and structure to support PPP projects worth over USD30 billion</p>	<ul style="list-style-type: none"> ▪ PPP Authority tendered first batch of projects based on defined role and structure ▪ Implemented full roll-out of recommended actions

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