

Toolkit:

A guide for hiring and managing advisors for private participation in infrastructure



Executive summary for ministers and senior officials



PPI advisory services

executive summary for ministers and senior officials

This summary sets out the key issues of interest for ministers and senior policy makers who are considering whether to hire advisors. It is one component of a larger Toolkit that defines the need for and the role of advisors at each stage of a Private Participation in Infrastructure (PPI) program. The summary does not discuss the details of PPI, nor does it address all of the issues that need to be considered when appointing advisors. The officials involved in taking forward reform or implementation should refer to the detailed manuals in the Toolkit for further information. (See the relevant cross-references.) Summary answers to a number of frequently asked questions are provided at the end of this summary.

Private sector provision of infrastructure

PPI has increased dramatically over the last decade.

Over the period 1990 – 1999 the private sector has made massive investment in infrastructure in developing countries. According to the World Bank’s PPI Database, the private sector invested \$580 billion in infrastructure in developing countries between 1990 and 1999. This trend is the result of increased recognition by national, state and local governments of the ability of the private sector to assume many of the risks involved in the construction and operation of infrastructure projects. The decrease in the funds available to national, state and local governments for infrastructure investment has also had an impact.

See Module 1 “Principles of selection of advisory services to support PPI” of *Volume I, What is PPI and how can advisors help?* for further information.

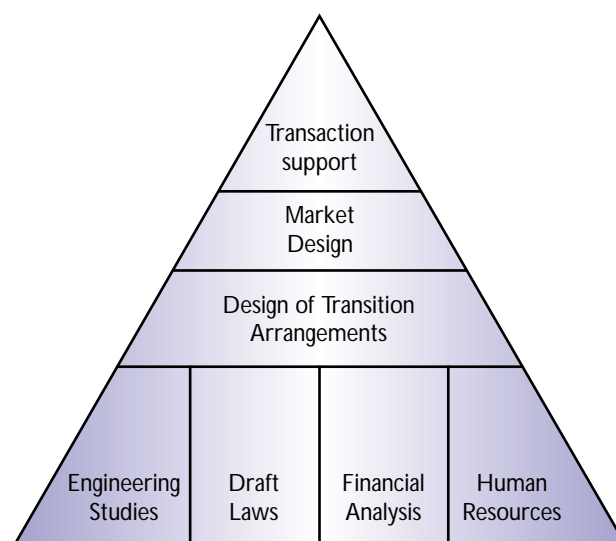
Complicated reforms require specialists in order to succeed.

Need for advisors

Governments embarking on introducing PPI need not, and should not, tackle the reforms unaided. Infrastructure is a large and relatively complex part of an economy. Affordable power, safe water supply, effective telecommunication services and reliable transport systems are vital to a country's economic growth and improved quality of life of its citizens. Specialist advisors can provide the requisite expertise and experience to ensure the success of the reform process, and have the necessary independence to advise on the appropriate path.

The advisory pyramid illustrates the range of tasks that advisors will undertake.

The advisory pyramid



Different tasks require different types of advisors.

Types of advisors

The many components of a reform program require a wide range of skills. While these vary from project to project, the main types of skills likely to be required include the following:

- **Economic:** knowledge of economics (and especially regulation, pricing and the incentives created by difference market and industry structures). Any one reform is likely to have a number of inter-linked elements to it – establishing a market and industry structure, deciding on an appropriate form of ownership and setting a legal and regulatory framework. Economic expertise should be fed into all these areas.
- **Financial:** knowledge of the process of introducing the private sector, the sale or lease of infrastructure assets and the impact of reform decisions on the ability to attract private finance.
- **Legal:** knowledge of both the local legal framework and best international practice in the drafting of legislation and contracts.

- **Technical:** knowledge of the engineering, operational and other technical aspects of the infrastructure sector in question, including the ability to divide assets both horizontally (e.g., creating many water companies where there was originally only one) and vertically (e.g., separating water distribution from bulk water supply). Engineers will also advise on the condition of existing assets, rehabilitation needs and new investment requirements.

Other specialists' services (e.g., public relations, pension funds and human resources) may also be required.

See Module 3 "The role of advisors – how can they assist?" of *Volume I, What is PPI and how can advisors help?* for further information.

A strong advisory team substantially improves the likelihood of success.

Advisory services and project success

Future private sector participation depends on investors' confidence in both the country and the government. The role of advisors will have an impact on whether potential investors decide to invest. Appropriate selection and use of advisors builds confidence in the reform process by:

- (1) **Demonstrating the existence of transparent and fair selection processes from an early stage.** Potential future investors will judge the government by its past actions.
- (2) **Attracting advisors with a strong reputation.** Their willingness to see their names attached to a project or piece of advice acts as a signal that they feel it is thorough and correct.
- (3) **Introduction of a well-designed reform program.** Where the new industry and market structures, contracts regulatory regime, and legal framework are comprehensive, potential investors will be re-assured that the government and its advisors understand the process with which they are dealing.

There are four main stages to the reform process...

The reform process

The precise process to be followed will depend on the project in question. However, four general stages can be set out:

- (1) Establishing the policy
- (2) Setting the legal and regulatory framework
- (3) Tendering the contract
- (4) Managing the contract

The emphasis on a particular stage will vary with each reform program. The creation of a competitive markets will mean little or no on-going management of a contract. At the other extreme, purchasing of a loss-making utility under a long-term concession will make substantial demands

on contract management. Part of the role of advisors is to develop a reform program which is appropriate to the project in question.

Economic advisors often take the lead during the initial stages of the PPI process.

Advisory input into stage one – formulating the policy

Setting the general framework (i.e. form of PPI, industry and market structure and regulatory framework) is mainly the responsibility of economists – whether sourced from specialist economic consultancies, or from banking, accounting or management consultancy firms with economic skills. Technical advisors (i.e. engineers) may also be called upon to contribute to the scoping of objectives of a PPI project or reform program since they will be required to provide information on existing infrastructure and on long-term investment needs.

Scope the project	Identify the options	Appraise the options	Choose preferred option
Lead			
Economic	Economic	Economic	Economic
Supporting			
Technical	Financial Legal Technical	Financial Legal Technical Environmental PR HR	N/a

See Module 3 “The role of advisors – how can they assist?” of *Volume I, What is PPI and how can advisors help?* for further information.

Advisory input into stage two – establishing the legal and regulatory framework

Initial and detailed design	Legislation and other legal instruments	Institutional development	Preparatory steps*
Lead			
Economic/Financial	Legal	Economic	Economic/Financial
Supporting			
Financial Legal Technical	Economic Financial Environmental Pension	Financial Legal Technical Pension HR	Financial Legal Technical Environmental Pension HR PR
* asset valuation, establish regulatory system, set initial tariff			

See Module 3 “The role of advisors – how can they assist?” of *Volume 1, What is PPI and how can advisors help?* for further information.

Legal advisors may take the lead on the drafting of legislations and regulations.

Economic advisors will play a prominent role in the initial design of competitive markets, regulatory systems and contract structures. As the work proceeds to detail design and preparation of legal instruments, the role of economists will decline and the role of other advisors – in particular legal advisors – will increase.

During the second stage legal advisors will draft or amend any laws required to put in place the agreed framework. Financial advisors will have a relatively small input into stage two of the PPI process. Their primary role will be to continue to advise on the impact of option changes on investor confidence. Financial advisors will additionally be involved in estimating asset values. Technical advisors will play a crucial role in the identification and valuation of the assets.

Depending upon the form of PPI, human resource advisors, environmental advisors, and pension and insurance specialists may be involved in establishing the legal and regulatory framework.

In the third stage of the process, the transaction is undertaken.

The role of advisors in the third stage – tendering the PPI contract

Financial advisors are generally best placed to ensure the success of the final transaction. Therefore, their main input comes during the third stage when the transaction is undertaken.

During the third phase, legal advisors will draft or amend any required contracts, licences or other agreements required to implement the reform, often under the *direction of the* financial advisors. The roles of economic and technical advisors will be limited to checking documentation

sent out in the request for proposals (RFP) for its economic and technical content. Their expertise might also be drawn on during the process of tender evaluation.

As the point of contract agreement draws closer, both legal and financial advisors will become more involved. Their roles will be particularly focused on the negotiation of the final contract. During stage three, the financial advisors will be involved in the detailed evaluation of the proposed contract, advising the government during the negotiations. The legal advisor will have primary responsibility for ensuring that the final commercial agreement is properly reflected in the binding documents. The legal advisors will also be involved in arranging for the various PPI parties to enter into the PPI project agreements. They will be able to advise on the various terms and conditions included in the main contract for services, and where relevant, supplier, construction and maintenance contracts.

There may also be an important role for legal advisors in reaching contract close. Contracts will often involve a set of conditions that must be met before the contract is fully effective. These may relate to finalizing, for example, the finance or concluding subsidiary contracts. The legal advisor will ensure that these conditions are met.

Public relations advisors will be involved in the later stages of a PPI transaction when the government is in a position to alert potential investors of a specific project.

Financial advisors often lead the selection, negotiation and transaction finalization.

Alert potential bidders	Draft IM*/ establish data room/issue RFP	Prequal/ shortlist/ finalise and issue RFP	Evaluate/ negotiate/ award contract
Lead			
Financial/PR	Financial/Legal	Financial	Legal/Financial
Supporting			
Procurement	Technical Environmental HR PR	Legal Technical Environmental PR HR	Economic Technical Environmental PR HR Procurement
*IM: information memorandum			

See Module 3 “The role of advisors – how can they assist?” of *Volume I, What is PPI and how can advisors help?* for further information.

Advisory input into stage four – managing the PPI contract

Once the PPI contract has been agreed, advisors may still be needed to undertake certain tasks. Economic advisors may be required to review performance indicators and evaluate the reform. Legal and financial advisors will be involved in any contract re-negotiation that might occur. Technical advisors will be involved in monitoring the contract.

Government plays a vital role in contract management.

Government

The ultimate success of the project depends on the government. It requires the government to select advisors appropriately, manage those advisors effectively, follow-up on the recommendations of advisors and manage the final PPI contract, license or other agreements. The presence of advisors with relevant skills and experience helps government meet its objectives, but does not remove its overall responsibility for success.

Recruit monitoring team	Monitor contract	Review Performance Indicators	Evaluate/ renegotiate
Lead			
Government	Government	Economic	Legal
Supporting			
HR	Economic Legal Technical	Technical	Economic Legal Technical Procurement

The process of timetable setting begins with an appropriate definition of requirements from advisors.

Setting realistic timetables

It is important that a realistic approach is taken to setting out the timetable over which tasks are to be undertaken by advisors. A consultancy project undertaken over too short a time runs the risk of generating inappropriate advice. Equally important, rushing to implement correct advice can cause problems (e.g., potential investors are not sufficiently informed about the opportunity and thus do not bid; or stakeholders feel they were not consulted and so resist the reform initiative).

Ideally a “bottom up” approach should be taken to setting a timetable. It should be based on the tasks that the project will comprise and an estimate of the time required for those tasks to be undertaken. Where the advisors will need to arrange meetings and discussions with a wide number of individuals or organizations, this should be reflected in the timetable. While political goals will inevitably influence the timescale for reform, they should not be the sole driver.

In addition, when setting the wider timetable for PPI reform (as opposed

to the timetable which advisors will work to) it is important to bear in mind that the whole process of selecting and hiring advisors can take several months. Time should be built into the overall PPI timetable to allow for this process.

On occasion, political imperatives will require a transaction to be delivered within a short period of time. However, the costs will be higher and the prospects of success lower when the timetable is too compressed.

Advisors don't come free.

Setting the budget

All too often, budgets for advisors are set during the public expenditure planning rounds or at the start of the financial year, well before there is a clear idea of the range, type and scale of the advisory services required. This approach can lead to problems if the resources allocated to paying for advisory services are insufficient.

Hence, just as a bottom-up approach should be taken to setting the timetable, a similar approach should be adopted for establishing the maximum budget allocated to the payment of advisory services. Ideally, the budget for advisory services should reflect the time that the government believes that it will take to complete all of the tasks to be undertaken. This means that the budget should be defined after the draft terms of reference have been drawn up. In addition, the budget should take into account not just the time required, but also the type of advisors that are needed.

In some cases, at least part of the advisors' costs can be financed within the transaction itself. For example, financial advisors may be paid a share of the sale price. While this still creates a cost to government or consumers, it also provides a stronger incentive for the advisors to deliver a successful outcome. However, this approach cannot be used for all advisors.

See Module 4 "Defining the project and the contract" of *Volume I, What is PPI and how can advisors help?*

The selection of advisors varies from project to project but should be transparent, fair, cost-effective and free of conflict of interest.

Selection of advisors

The selection of advisors will vary from project to project depending, in part, on the country in which it is being undertaken, the type of project and the source of financing. However, best practice selection should follow four main rules.

- **Transparency:** as much information as possible should be made publicly available. A transparent process eliminates doubt about the quality of the final winning team. Furthermore, it is a pre-requisite to the participation of most top consultancies, who will not bother to participate in a process that is opaque and difficult to understand.

- **Fairness:** all parties are treated equally. All parties receive the same information at the same time, and are evaluated on the same criteria.
- **Cost-effectiveness:** costs should be minimized without sacrificing quality. Costs can be minimized and quality of service maintained by choosing and employing the appropriate selection method (e.g., a form of competitive bidding and by understanding the likely cost components of the work while drafting the terms of reference).
- **Freedom from conflicts of interest:** the selection process should avoid both actual and perceived conflicts of interest. This requires avoiding the participation of companies that may be involved as investors or consumers, the participation of government officials who have current or recent connections to the companies involved and the linking of rewards to anything other than performance.

Under most circumstances selecting advisors will follow a competitive tendering process.

See Modules 7 and 8, “Selecting advisors” and “Paying advisors for their help” in *Volume III, How to select and manage PPI advisors* for a discussion of other approaches to selecting advisors.

When is competitive tendering appropriate?



Note: The dollar amounts are indicative only

Help with paying for advisory services

Paying for advisors can be costly. Many of the donor agencies provide an external source of funds for hiring advisors. Further, donors can provide expertise in the hiring process that governments can use to ensure that they choose appropriate advisors. Donor agencies also have experience in project management to ensure that the governments' advisors perform satisfactorily. Donor agencies often place restrictions on the government related to the eligibility of potential advisors and require the use of their own procurement rules which contain prescriptive guidelines for the hiring of advisors.

There are broadly two sorts of donor agencies from which governments can obtain funds for advisory services (often called "technical assistance"). Most developed countries have bilateral aid agencies and/or trust funds that provide funds on concessional or grant terms to other governments and foreign entities. In addition, many governments contribute funds to multilateral donor agencies that then lend the funds, on both market and concessional terms, to governments in developing countries. The main multilateral and bilateral agencies are outlined in Tables 1 and 2 respectively.

See Module 6, which is *Volume II, The role of donor agencies in PPI* for more details about donor agencies and other sources of funds.

Table 1
Main multilateral agencies

Agency	Aid Coverage*	Technical Assistance lending***, US\$ million (year ending)
World Bank: IDA/IBRD	Global	706 (1999) ^
Asian Development Bank (ADB)	Asia	173 (1999)
Inter-American Development Bank (IADB)	Central and South America and the Caribbean	106 (1998)
African Development Bank (AfDB)	Africa	61 (1998)
European Bank for Reconstruction and Development (EBRD)	Eastern Europe, Former and Current Soviet States	597 (1998) ^ ^
United Nations Development Program (UNDP)	Global	N/a
European Union (PHARE, TACIS)**	TACIS: former Soviet states, Russia and Mongolia PHARE: Eastern Europe,	TACIS: <430 (1998) ^ ^ PHARE: <900 (1998) ^ ^ (est, TA not separated from project lending)
Caribbean Development Bank (CDB)	Regional members cover the Caribbean	< 50 (est, TA not separated from project lending)

*: membership often includes states outside the area in which the organization provides funds.

** : the EU also has a regular TA program run through the Commission. Funding from the program depends on bilateral agreements between the EU and the government in question.

***: Technical Assistance lending refers to loans offered specifically to pay for the hiring of advisors. These figures do not include trust funds managed by the multilateral aid agencies or technical assistance funded out of sectoral loans.

^ : excludes trust funds managed by the World Bank which disbursed approximately US\$1.3 billion in fiscal year 1999.

^ ^ : based on Euro 1.15 = US\$1.

N/a – Not available.

Table 2**Main bilateral agencies**

Country	Agency*	Contact details	Coverage
Canada	CIDA	Http://www.acdi-cida.gc.ca/index.htm	Global
Denmark	DANIDA	Http://www.um.dk/	Mainly sub-Saharan Africa
France	AFD	Http://www.afd.fr/	Mainly North and West Africa
Germany	GTZ	Http://www.gtz.de/	Mainly Africa
Japan	JBIC	Http://www.jbic.go.jp/	Mainly Asia
Norway	NORAD	Http://odin.dep.no/ud/engelsk/index-b-n-a.html	Mainly Africa
Sweden	SIDA	Http://www.sida.org/Sida/jsp/Crosslink.jsp?d=107&a=4827&v=7	Mainly sub-Saharan Africa and South Asia
Switzerland	SDC	http://194.230.65.134/dezaweb2/home.asp	Global
UK	DFID	Http://www.dfid.gov.uk/	Mainly Commonwealth
USA	USAID	Http://www.usaid.gov/	Global

Institutional reform is an integral part of the PPI process.

Early on in the process, a government intent on reform should consider the institutional changes that will be required to implement the PPI or sectoral reform program. The reform process will need a structure for political management and a structure for official control.

There are three approaches that can be taken to institutional reform.

There are a number of institutional models that can be adopted.

- **A centralized approach** – the government establishes a unit to manage the PPI process within a central department, such as the finance ministry.
- **A decentralized approach** – the government establishes a dedicated unit within the department or ministry that has responsibility for the sector that is being reformed.
- **A hybrid approach** – line ministries or agencies retain responsibility for the PPI implementation but a central unit provides best practice and advice on PPI implementation to other ministries. Alternatively a dedicated unit could be formed from one or more ministries.

There is no simple answer to the question of what is the best institutional design for managing the PPI process. The solution will need to reflect the circumstances of the individual sector, country and PPI reform in question. Irrespective of the approach chosen, however, it is of crucial importance that those in charge of the PPI process have the authority, funding and other resources to undertake the set of necessary tasks. The set of skills required and the time needed to manage advisors properly should not be under-estimated. Poor management of good advisors will only waste valuable public money. Consequently, governments may need to make special arrangements to recruit and retain the best individuals to manage PPI advisors.

See Module 9, "Managing the PPI advisory services" in *Volume III, How to select and manage PPI advisors*.

The Decision-Maker's Reference Guide to Hiring and Managing PPI Advisors

Outline

This mini-guide draws out the common problems faced by those selecting advisors and summarizes solutions. It provides a set of common questions that arise and brief answers to them—along with references to the main guides for more detailed information.

Question	Answer	Reference
Will increasing the role of the private sector in infrastructure benefit our country?	<p>PPI has a number of advantages:</p> <ul style="list-style-type: none">• It transfers some of the risk associated with managing, operating and/or investing in infrastructure from the government to the private sector.• It can increase efficiency of basic services, and so reduce costs.• It frees up government funds for use elsewhere, e.g., in poverty alleviation.• It brings new expertise into the sector.	<p>For more detail on this question see Modules 1 and 2, "Principles of selecting advisory services to support PPI" and "Identifying the stages of PPI – what is PPI?" in Volume I, What is PPI and how can advisors help?</p>
Do I need to hire advisors?	<p>However, the PPI process is complex and, in order to create these benefits, requires expertise that may not exist within government.</p> <p>Using the private sector to provide advisory services has a number of advantages.</p> <ul style="list-style-type: none">• It allows the public sector to access global and technical expertise often not present in the government.• It can prevent the government from making costly mistakes.• It facilitates the transfer of knowledge from the private to the public sector.• It brings legitimacy to the PPI process – the use of independent advisors can often place an external stamp of endorsement on the government's proposals, increasing investor and public confidence <p>If the government is contemplating PPI, then it should take advantage of the expertise in the private sector.</p>	<p>For more detail on this question see Module 1 and 2 "Principles of selecting advisory services to support PPI" and "Identifying the stages of PPI – what is PPI?" in Volume I, What is PPI and how can advisors help?</p>

Question	Answer	Reference
<p>Will increasing the role of the private sector in infrastructure benefit our country?</p>	<p>Advisors cover a wide range of specialities, including economic, financial, legal, technical, and management. Depending on the requirements of the project, a different mixture of advisors will be required.</p> <ul style="list-style-type: none"> • Economic advisors are required for PPI policy formulation and whenever new industry structures or arrangements (e.g., unbundling, regulation, pricing) are being put in place. 	<p>For more detail on this question see Module 3 “The role of advisors – how can they assist?” in Volume I, What is PPI and how can advisors help?</p> <p>For more detail see section 3.2.1 in Volume I, What is PPI and how can advisors help?</p>
<p>Do I need to hire advisors?</p>	<ul style="list-style-type: none"> • Financial advisors are required whenever a transaction will be undertaken. • Legal advisors are required whenever the drafting or interpretation of legislation or contracts is a project component. • Technical advisors are required for valuing assets, setting performance targets, and determining investment needs. • Management or human resource advisors are required if the reforms have implications for staffing, organizational structures, training and other labor-related issues. <p>In addition there are a range of advisors covering more specialist issues such as public relations and the environment. Depending on the scale and complexity of the required advice only a subset of these advisors may be required—and some may be able to fulfill multiple roles.</p>	<p>For more detail see section 3.2.2. in Volume I, What is PPI and how can advisors help?</p> <p>For more detail see section 3.2.3 in Volume I, What is PPI and how can advisors help?</p> <p>For more detail see section 3.2.5 in Volume I, What is PPI and how can advisors help?</p> <p>For more detail see section 3.3.6 in Volume I, What is PPI and how can advisors help?</p>

Question	Answer	Reference
Is it worth appointing lead advisors to manage the process of reform?	<p>Whether it is worth appointing lead advisors will depend upon the specific project or program being considered and the capabilities or experience of government staff.</p> <p>Lead advisors will be particularly useful when knowledge of PPI reform within government is limited, when considering large and complex programs of reform and/or when there is little capacity within government to manage the process.</p> <p>On the other hand lead advisors are expensive and may have incentives to limit the amount of out-sourcing to increase their own revenues, to the detriment of the quality of advice provided.</p>	For more detail on this question see Module 3 "The role of advisors – how can they assist?" in Volume I, What is PPI and how can advisors help?
How can I raise the money required to hire advisors?	<p>In addition to internal government sources, a wide range of agencies provides funding for advisory services. There are two main types of funding – grants and concessional loans. Multilateral (e.g World Bank, UNDP, Asian Development Bank) and bilateral (e.g., UK Department for International Development or USAID) agencies provide a variety of grants and concessional loans for advisory services. The source of funds will depend on the per capita income of the country, its location and its membership in the multilateral and bilateral institutions.</p> <p>To varying degrees, it is also possible to retain advisors on the basis of the revenues they deliver to the Government, for example a share in the sale proceeds. When part of an actual transaction, this may be an effective way of financing advice and giving advisors the right incentives.</p>	For more detail on this question see Module 6 in Volume II, "The role of donor agencies in PPI"

Question	Answer	Reference
Do the benefits of PPI outweigh the costs of advisors?	For nearly all projects, the benefits of well-designed PPI (and the associated industry and sector restructuring and regulation programs) in developing and transition economies will outweigh the one-off costs of advisors. This is reinforced by the experience of governments who have tried to implement reforms without advisors and made costly mistakes. For smaller projects, it is particularly important to take measures to minimize costs (e.g., combine projects, combine advisory tasks).	For more detail on this question see the Overview to the Toolkit and Module 7 “Selecting advisors” in Volume III, How to Manage and Select PPI Advisors
How can I ensure that good advisors are interested in providing me with advisory services?	It is important to recognize that the best advisors have a wide range of opportunities. While winning projects is what makes them profitable, advisors will look elsewhere if either the chances of winning are very remote or the project would not be profitable if won. Therefore, the process of selecting advisors is not solely one of advisors trying to impress the evaluators but also of the government, or other agency, selling the particular opportunity. In order to attract the best advisors it is important that the: <ul style="list-style-type: none"> • project is well thought-out and clearly presented; • evaluation process is transparent; • funding is sufficient and the sources clearly indicated; and • shortlist of eligible firms is not longer than 5-6 companies. 	For more detail on this question see Modules 4 “Defining the project and the contract” in Volume I What is PPI and how can advisors help?, Module 7 “Selecting advisors” and Module 8 “Paying advisors for their advice” in Volume III, How to select and manage PPI advisors
How should I determine which company is the best for my needs?	Competitive bidding generally provides the best indication of the cost and quality that companies can offer. The evaluation criteria (e.g., balance between the technical quality and cost) will determine both the company that wins and the composition of the winning team. The decision about the appropriate weighting should be determined by the degree to which it is possible to control the risk of bad performance, the characteristics of the project, and the flexibility of the funds available. Only under certain specific circumstances (e.g., emergency situations, highly specialized needs or very small projects) should alternatives to competitive bidding be considered.	For more detail on this question see Module 7 “Selecting advisors” in Volume III, How to select and manage PPI advisors

Question	Answer	Reference
<p>How should I manage and oversee the company that I hire?</p>	<p>Project management encompasses a wide range of issues. Two main questions are the following.</p> <p>(1) How does the government ensure quality over something about which it may have relatively little knowledge and the results of which may not be evident until after the project is completed?</p> <p>(2) How does the government prevent the project running over time or over budget, or both?</p> <p>Quality assurance</p> <p>There are a number of possible measures.</p> <ul style="list-style-type: none"> • If the source of funds is a lending agency then it can assist with quality assurance, drawing on experience from similar projects elsewhere. • The advisors may be provided with incentives to perform such as payment milestones tied to specific outputs, success fees, bonus points for future competitive tenders, shares, positive evaluations and performance references. • A lead advisor hired on a longer term contract may be used to assess the quality of the shorter term work. <p>Keeping within budget</p> <p>There may be legitimate reasons for projects over-running (e.g., new tasks appeared once the project was started). However, it is vital that the government can distinguish between the valid and invalid reasons. In addition to ensuring there is a manager in government that keeps track of time and budget, several other measures should be considered.</p> <ul style="list-style-type: none"> • Lump sum contracts provide maximum incentives for companies to finish on budget and within the time suggested. Their disadvantage is that companies may sacrifice quality to do so. • Potential for future work provides an incentive to complete current work on time and budget as well as to the quality required. • Success fees give companies incentives to make their own decisions about how far it is worth committing further resources in an attempt to improve the outcome. 	<p>For more detail on this question see Modules 8 “Paying advisors for their advice” and Module 9 “Managing PPI advisory services” in Volume III, How to select and manage PPI advisors</p>

Toolkit:

A guide for hiring and managing advisors for private participation in infrastructure



What is PPI and how can advisors help?



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Table of contents

Section	Page
Acknowledgements	
1. Principles of selection for advisory services to support PPI	1
1.1 Private sector involvement can increase efficiency – and access new sources of finance	1
1.2 Governments still play a fundamental role	5
1.3 Governments can use the private sector to meet objectives more effectively	6
1.4 Effective use of the private sector requires a strong advisory team	7
1.5 Obtaining a strong advisory team is expensive and presents a challenge	7
1.6 Governments need to purchase advisory services effectively	10
1.7 A strong government team will reduce the concerns of potential investors	12
2. Identifying the stages of PPI – what is PPI?	13
2.1 Stage 1: Formulating policy	15
2.2 Stage 2: Setting the legal and regulatory framework	25
2.3 Stage 3: Tendering the contract	30
2.4 Stage 4: Managing a PPI contract	38
2.5 Variations from the standard PPI process	40
3. The role of advisors – how can they assist?	47
3.1 When to appoint advisors	47
3.2 Lead advisors	51
3.3 Differing types of expertise needed to guide officials through the PPI process	53
3.4 Role of advisors in stage 1 - policy formulation	62
3.5 Role of advisors in stage 2 – establishing the legal and regulatory framework	67
3.6 Role of advisors in stage 3 – tendering the contract	80
3.7 Role of advisors in stage 4 – managing the PPI contract	92

3.8	Use of local advisors	.97
3.9	Use of advisors by potential investors	.98
	Useful Reading	.101
4.	Defining the project and the contract	.102
4.1	Scoping consultancy projects	.102
4.2	Resolving conflicts of interest	.111
4.3	Designing appropriate payment methods	.115
4.4	Packaging advisory services	.116
4.5	Meeting constraints	.117
5.	Use of advisors for small-scale projects	.119
5.1	Definition of a small project	.119
5.2	Project implementation	.121
5.3	Role of advisors	.123
5.4	Role of the competitive tendering process	.127
5.5	Risks	.129
	Useful Reading	.129
	Glossary	.130

1. Principles of selection for advisory services to support PPI

Outline of this Module

What this Module does:

This Module describes the rationale for increasing private sector participation in infrastructure, and the implications for selection of advisors. It outlines the basic tenets of selection and the link between a successful Private Participation in Infrastructure (PPI) program and the proper use of advisors.

The Module provides an initial overview of PPI and the use of advisors. It does not enter into any detail about their selection or use, which is covered in later Modules.

Who should read this Module:

The Module should be read by officials from central agencies within government who are responsible for setting policy for private sector participation and the use of advisors; officials from ministries involved in the implementation of specific reforms; and the staff of financial or other agencies that handle procurement. Officials involved in implementation should use it as an introduction to the process of procuring advisors for PPI.

1.1 Private sector involvement can increase efficiency – and access new sources of finance

Over the period 1990–1998 the private sector made massive investment in infrastructure sectors in developing countries around the world. Figure 1-1 shows the investment expenditures in projects with private sector participation (PSP) by main infrastructure sector (energy, telecommunications, transport, and water and sanitation) and year.

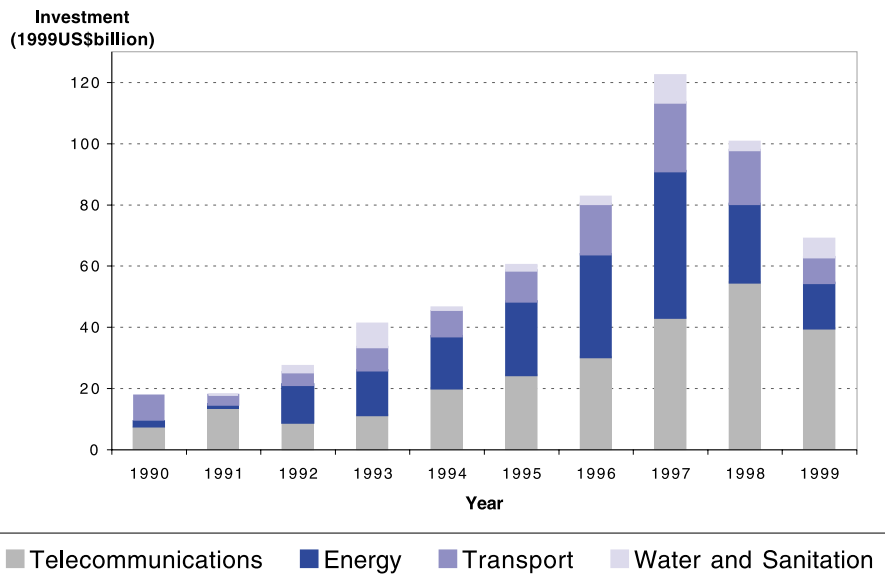
Defining the term PPI:

PPI = Private Provision of Infrastructure

PPI refers to the use of the private sector to manage, maintain, expand, operate and/or invest in infrastructure services. The areas of infrastructure covered by this toolkit include: energy, telecommunications, transport and water and sanitation.

Figure 1-1

Total investment in infrastructure in developing countries, by sector (1990–1999)

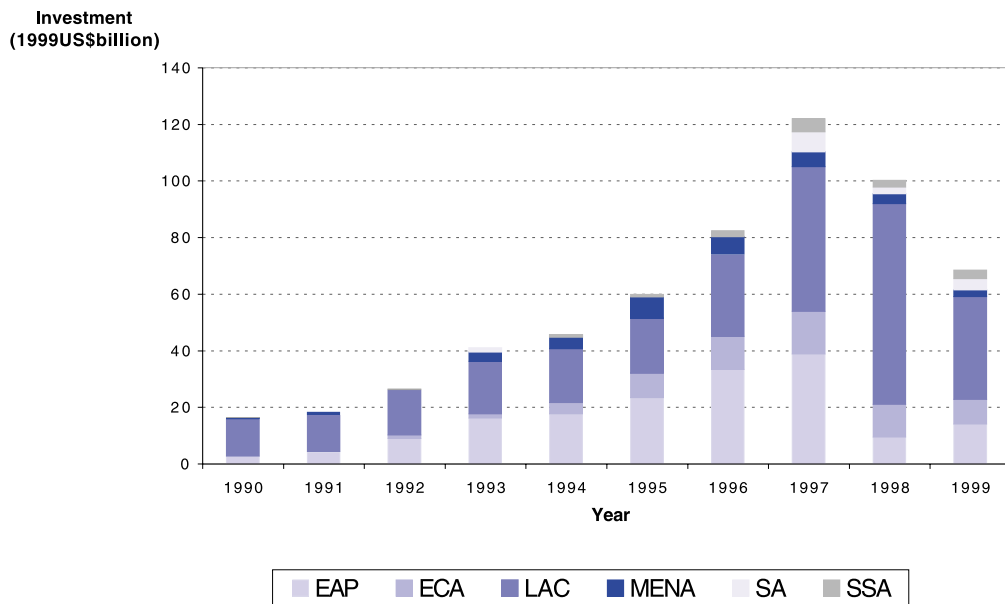


Source: World Bank, PPI Database

Note: Developing countries, defined as low and middle-income countries by the World Bank

Figure 1-2

Total investment in infrastructure in developing countries, by region (1990–1999)



Key:

EAP: East Asia and Pacific

LAC: Latin America and Caribbean

SA: South Asia

ECA: Europe and Central Asia

MENA: Middle East and North Africa

SSA: Sub-Saharan African

Source: World Bank, PPI Database

Note: Developing countries, defined as low and middle-income countries by the World Bank

The figures show a steady rise in private participation in PPI¹ until the financial crisis that struck Southeast Asia and subsequently spread throughout the developing world. Available data indicate that investment interest is returning in response to the region's recovery.

Despite the large inflow of funds, there is significant unmet demand for PPI. As governments become increasingly comfortable with transferring risk to the private sector, and as new financial instruments and contracts are created, demand for private investment increases. There are two main reasons for the overall increase in, and demand for, PPI:

(1) Increased recognition by national, state and local governments of the ability of the private sector to assume many of the risks involved in the construction and operation of infrastructure projects.

The transfer of additional risks to the private sector provides increased incentives to manage these risks appropriately, leading to better investment decisions and more efficient service provision. While these incentives are broadly similar to those in the public sector aimed at ensuring a well-managed service, private companies, driven by the needs of shareholders and financiers, face closer scrutiny, which strengthens these incentives. These groups tend to be more demanding –

¹ PPI is a subset of private sector participation (PSP)—it is PSP in infrastructure.

and better informed – than taxpayers. Provided that PPI is well structured, this pressure should deliver the government's objectives more effectively.

(2) Decreased funds available to national, state and local governments for infrastructure investment, both when compared to total investment requirements and to many other possible uses for these funds.

Private participation does not change the need for consumers or taxpayers to pay for major investments. The government's financial position is not fundamentally changed if it pays for a service (e.g., water provision) rather than for assets (e.g., a storage dam and pipelines).

However, private participation can bring financial benefits. The costs may be lower if efficiency is increased. Major discrete financing requirements will be smoothed over a number of years. The greater clarity required for PPI also means that major investment, operational and management decisions and their financial implications will be better managed.

Restructuring may also reduce or remove the need for government financing. For example, if investments in electricity generation can be secured against future sales of electricity, the government does not need to be directly involved in financing. In theory, this is not an issue of ownership: a government-owned company could equally have secured finance against future revenue. In practice, the involvement of private companies often creates the impetus for the government to withdraw.

In recent years, governments have transferred more significant risks to the private sector for infrastructure provision. Increasingly, this has meant that private companies are not only exposed to the risk of completion on time and within budget (as happens when contractors build a runway, a bridge, or a treatment plant for a public authority); they are increasingly exposed to risks of whether a project is needed at all, whether it meets quality requirements, and whether its costs of delivery are competitive in the long term, as well as many of the environmental risks associated with infrastructure projects.

There are several entities over which the risks associated with PPI may be spread:

- government (i.e., tax payers);
- consumers;
- the project company that sponsors a project;
- the construction company that builds it;
- the financiers that back the project; and
- the operations and maintenance company.

It is the assumption of significant risk by the private sector in the provision of infrastructure that is captured under the broad term PPI. The precise risk transferred to the private sector will depend on the form of PPI (e.g., service contract, concession or equity sale) and the project in question. The link between risk and the different forms of PPI is examined in detail in Module 2. Table 2-2 presents a more detailed outline of the risks associated with PPI.

1.2 Governments still play a fundamental role

Increased PPI is often accompanied by structural changes in public sector industries. The reform model has implications for the successful structuring of PPI and also implies a number of economic and political changes that encompass:

- the current budgetary spending on infrastructure;
- government policy;
- the role of competition as the private sector is introduced;
- the government's responsibilities with the introduction of PPI; and
- the appropriate internal organization of government to implement PPI.

Budget

In most developed and developing countries, governments raise and spend directly 30–50% of GDP, using these funds to provide the framework for civil society: law and order, the justice system, defense, foreign affairs and other public goods. All too often, the definition of public goods is stretched to encompass services which could be provided efficiently without tapping to government's budget.

Defining public goods

A **public good** is one where the benefits of its provision cannot be limited only to those who pay for it, and where its use does not limit the quantity available to others. Street lighting is an example of a public good. Anyone using the street benefits from the light and the fact that one person uses it does not decrease the amount available for someone else.

In some countries, public goods are defined broadly and, as a result, significant sums are spent on welfare payments. This is almost universally true of education and health services. To varying degrees, governments also provide a much broader range of services across areas that are not strictly public goods: water and sanitation, transport, power and telecommunications. In most cases, cost recovery for these services from end users is possible and provision can be limited to those who pay for it.

Policy

Governments around the world have increasingly recognized that their role should be in setting policy for service provision, and not in providing services. This separation of policymaking from provision makes it possible to introduce the private sector, and competition, in the provision of assets and services. Along with the transfer of risk, competition is the most effective tool for increasing efficiency and reducing costs.

Competition

Increasingly, governments have also found that their policy objectives can be fully met within a competitive market. Their policy role may then be reduced to setting the framework for competitive markets (e.g., introducing competition laws to avoid abuse of market power). Over the last decade, many governments have reduced their direct involvement in many industries and have relied on the workings of the competitive market to protect consumer interests.

Recommendation 1.1: Effective PPI requires that responsibility for the provision of a service be separated from government policy-making. The structure for PPI should ensure that these responsibilities are clearly assigned and separated.

Target-setting

It is increasingly common for governments to set themselves and their representatives explicit targets for withdrawing from direct oversight of infrastructure industries. In Poland, the energy regulator has a legal obligation to withdraw from the direct oversight of the electricity generation market as soon as it is sufficiently competitive. Although this creates another set of challenges (i.e., deciding when the market is sufficiently competitive to permit withdrawal), it recognizes the ability of a competitive market to meet some of the government's objectives.

1.3 Governments can use the private sector to meet objectives more effectively

While some services can be provided through interaction between consumers and the market, there are important areas where there is less scope for government withdrawal.

The presence of natural monopolies

The first is where prices cannot be set through competition due to the existence of a natural monopoly.

This might be true of a rail line or a gas distribution system, where—it is more efficient to have a single integrated network servicing a particular area, rather than several competing networks.

What is a natural monopoly?

A **natural monopoly** exists when costs decrease as the amount produced within a single company increases. Ever-decreasing costs within the company mean that it is more efficient for a single producer to meet demand than several smaller producers.

Governments may still favor private participation in these areas but want to avoid the risk to consumers from private monopolies. One way forward is to allow a private company to own and operate the utility, but under the scrutiny of an independent government agency—a regulator.

Provision of loss-making services

A second area from which the government cannot withdraw is the provision of a necessary but loss-making service. There are many reasons why governments might want services to be provided, even at a loss. Public transport may be subsidized because the cost to society of private transport in terms of environmental degradation (from pollution) and quality of life (from traffic congestion) cannot be fully recovered from automobile drivers. Road systems are usually provided free, in part because of the difficulty of charging. Water and other services may be intentionally under-priced for reasons of public health. Postal services in rural communities are often cross-subsidized by urban populations for reasons of social equity.

It is important to note that a loss-making service does not have to be provided by a government. The private sector can be contracted to supply the service, for which it receives an explicit payment from the government, or certain consumers may be provided with a direct subsidy from the government to pay for the service. The benefits of competition can then still be realized through periodic competition for the contract.

Using competition where subsidies are required: rural-electrification in Chile
In Chile, the subsidies required for rural electrification are competitively bid. Private companies, alternative providers (e.g., NGOs, cooperatives) and communities present proposals at regular auctions for a specific amount of subsidy. The proposals are then evaluated based on a known set of criteria (e.g., amount of subsidy required, cost-benefit analysis) and the winning proposals are given funds. This process combines the need for continued government funding with the benefits of competition to minimize the public subsidy, allowing the government to serve more communities. To date the program has met its pre-set targets for rural electrification.

1.4 Effective use of the private sector requires a strong advisory team

Regardless of the intended mix between the public and private sectors in providing a particular service, the success of any PPI program depends on the organization of government and its ability to use advisory services. Before a technical assistance² project is undertaken, it is important to decide how its results will be disseminated and acted upon. In particular, it will be important to answer the following questions:

- To whom will the advisors report?
- What level of official input is required to ensure effective implementation?
- Have the relevant officials been informed about the upcoming decisions?
- Do ministers know of and support the process?
- If ministers or the head of state must take decisions, has sufficient time been set aside for them to act?
- Have the relevant resources been freed up?

Recommendation 1.2: The senior official responsible for a PPI initiative should select a strong government team. The government team should have clear responsibilities for managing the advisory team, and should establish lines of communication to all other relevant senior officials for full consideration of the advisors' recommendations.

1.5 Obtaining a strong advisory team is expensive and presents a challenge

Sections 1.1 and 1.2 described significant changes to large sections of the economy. They also described the positive impact of these changes. Since achieving these positive impacts depends on properly implementing the changes, outside expertise may be needed to:

- identify the changes required to meet the government's objectives;
- recommend the best way to implement the required changes; and
- assist in the implementation.

The expertise required for answering the questions outlined in Section 1.4 may not exist within the government. External advisors may be required.

The advice needed to implement a major reform program can be expensive. Table 1-1 provides an example of the range of fees used across a number of projects ranging from basic institutional analysis to the full range of policy, legal, technical assistance and transaction advice.

² The term "technical assistance" will be used throughout the Toolkit to refer to all services provided to governments that are in the form of advice rather than goods or works.

Table 1-1
Representative costs of hiring advisors

Country & year	Project	Type of advisors	Fee structure	Fees at time of contract
Pakistan (1985-87)	BOOT project –Lakhra power – led to Hub River Project	Financial advisors	Fixed fee	\$US 350,000 approximately
Cambodia (1996-98)	Institutional strengthening in water supply sector.	Financial, technical and legal advisors	Fixed fee	\$US 500,000
Georgia (2000)	Restructuring of Ministry of Transport and Communications as part of wider liberalization program	Technical advisors, transport planners, institutional reform experts, IT advisors and economists	Fixed fee	\$US 1 million approximately
Philippines (1995)	Water concession for Manila	Economic, accountants, lawyers and engineers. International Finance Corporation acted as lead advisor.	Mix of success and fixed fees	More than \$US 3 million
Uganda (1998–99)	Privatization of electricity industry	Strategic advisors to advise on the structural and appropriate forms of PPI for different parts of the industry, and transaction advisors for the privatization	Fixed fee	More than \$US 2 million
Brazil (1990s)	Privatization of electricity industry	Lead advisors, policy, legal, financial and other specialist advisors	Mix of fixed fee and success fees	\$US 10–12 million

Source: Frontier Economics

Governments spend such large sums on advisors because of the benefits they obtain from them, including the avoidance of costly mistakes.

However, governments face a significant challenge in managing advisors in order to obtain the best service from them. Managing advisors involves a number of steps.

- First, the government must identify the individuals or companies best placed to undertake the project .
- Second, the government must sign contracts that provide the advisors with incentives to use their expertise for the benefit of the government .
- Third, the expertise must be channeled into designing and implementing a PPI program that meets the government’s objectives.

The Toolkit outlines each of these steps.

The following Modules in *Volume I, What is PPI and how can advisors help?* :

- provide background information on PPI, outlining the different stages of the process;
- identify areas in which advisors can be used productively;
- discuss how a technical assistance project should be scoped; and
- consider issues related to the use and selection of advisors when PPI is being introduced on a small scale at the community or municipal level.

Managing a large and expensive group of advisors from differing disciplines is challenging in any country. It can be more challenging in a low-income country. The gap between host country officials and advisors may be large in terms of income, experience and understanding of the local culture.

Capable management of the advisory team is essential for three reasons:

- It is vital to the successful design and implementation of the reforms;
- Good management of advisors will reduce the need for senior officials to intervene as problem solvers; and
- Effective management of the advisory team will convey the government's competence and conviction to potential bidders for a PPI project, and may lead to greater market interest.

1.6 Governments need to purchase advisory services effectively

The first management challenge is to decide which advisory services are required and how they are to be selected. Most governments have formal rules relating to procurement. These usually vary according to the project characteristics, with the formal requirements increasing with the size of the contract. Increased formality may relate to the need for competition, the involvement of multiple parties (including agencies with specific skills in procurement) in decision-making, the types of funding, and payment arrangements. It may also relate to the process for review of the completed project.

This section describes the general characteristics of an effective selection process. It also looks at the particular characteristics of buying advisory services for PPI.

The main objective of a selection process is to hire the company or group of companies (consortium) that best meets the government's needs. This will include a focus on cost and quality, and may reflect other criteria, such as ability to deliver within a particular timeframe.

In deciding on the appropriate company or consortium, it is vital to recognize the trade-off between cost and quality. While the most expensive company or consortium will not necessarily provide the highest quality, in general it is true that the government will get what it pays for. Module 7 in *Volume III* outlines in detail approaches to ensuring the best balance between cost and quality.

Selection processes will differ from country to country and project to project. However, the process of finding the best team³ should have the following characteristics:

- **Transparency** Transparency is achieved when as much information as possible is made publicly available. A transparent process eliminates doubt about the quality of the final winning team. Furthermore, openness is a pre-requisite to the participation of most top consultancies, which may not participate in an opaque, difficult to understand process. Processes should also be open to the normal mechanisms for government review and appeal.
- **Fairness** Fairness is achieved when all parties are treated equally: when they receive the same information at the same time, and are evaluated on the same criteria.
- **Cost-effectiveness** Costs can be minimized by choosing the appropriate method for selecting service providers, e.g., the form of competitive bidding or sole-sourcing (see Module 7 in *Volume III*, How to select and manage PPI advisors). Accessing grant funds, or loans on concessional terms where available, reduces costs to government (see the Module in *Volume II*, *The role of donor agencies in PPI*).
- **Mechanisms to avoid conflicts of interest** The selection process should avoid both actual and perceived conflicts of interest. These include the participation of companies that may be involved in later stages of PPI, the participation of

³ Where a team may be a single individual, company or group of companies.

government officials who have current or recent connections to the companies involved, and the linking of rewards to anything other than performance. Conflicts of interest are discussed in more detail under areas where they most frequently occur (see Modules 3 and 4 and Module 6 in *Volume II*).

Recommendation 1.3: A government should implement a selection system that is transparent, fair and cost-effective, and which does not involve conflicts of interest. The effect of such a selection process will be to increase the likelihood of selecting the most appropriate consortium and to increase investor confidence in future PPI programs.

Selection of advisors for PPI raises three issues in addition to the general procurement principles discussed above.

Uncertainty

Purchasing advice always has an element of uncertainty: if the purchasers fully understood the advice in advance, they would not need to purchase it. This problem applies to a greater extent in PPI advisory services because of the combination of the large scale restructuring of an industry often required and the infrequency of the advice. The scale of the restructuring required increases the cost of any mistakes. The infrequency of the advice means that government officials are likely to be less able to monitor the consultants, and the consultants have fewer incentives to produce an output of the highest quality because they are less likely to be required again regardless of the outcome.

That creates a challenge in evaluating proposals. Possible solutions include:

- identifying the core skills of different types of advisors, and ensuring that these are reflected in the proposals received;
- appointing a lead advisor to assist in subsequent selection of other advisors;
- seeking out independent individuals or institutions with relevant experience to help in the evaluation and monitoring – aid donors are a possible source; and
- transferring risk so that the private company bears costs of poor performance as far as possible.

These are discussed in more detail in Module 7 in *Volume III*. (See section 7.1.)

Perception

The selection of advisors has an impact on the perception of potential investors. Well-delivered advisory services increase the credibility of the entire PPI process. Therefore the appointment is likely to have major impacts on the level of interest and the value received from any future transaction. While this does not alter selection processes, it does mean that more weight will be attached to the outcome of the advisory selection process than to a contract that has no broader ramifications for future investment.

Skill

There is a particular need to ensure the transfer of skills to local personnel. Some skills (e.g., economic regulation) will be required on an ongoing basis. Other skills will be useful to acquire for the future reform of other sectors. Several sectors may go through similar processes of reform, restructuring and inviting PPI. Attention should

be devoted to developing relevant skills within government, and among domestic advisory companies. This is discussed in more detail in Module 3.

1.7 A strong government team will reduce the concerns of potential investors

Developing country environments can be difficult for international investors. They are attracted because they see opportunities for profit, but they are deterred by risks. While commercial risks are manageable, political risks - that selection processes will be biased, that regulators will not prove fully independent or that legal remedies may prove hard to enforce - may be more challenging.

Risk and, equally importantly, the perception of risk can be reduced in three ways:

- **By demonstrating the existence of transparent and fair selection processes from an early stage.** Potential future investors will judge the government by its past actions. A selection process for advisors that is transparent, fair and cost-effective, and which does not involve conflicts of interest provides increased comfort to those contemplating the commitment of significant sums of money at a later stage.
- **By attracting advisors with a strong reputation.** Companies and individuals with excellent reputations have more to lose by making a mistake. Their willingness to see their names attached to a project or piece of advice acts as a signal that they feel it is thorough and correct. This is particularly important as the government gets close to a transaction.
- **By introducing a well-designed reform program.** Where the new industry and market structures, contractual and regulatory regime, and the legal framework are well explained and fit together logically, potential investors will be reassured that the government have designed a program that protects their interests.

Useful reading

Bouin, O., *Privatization in Developing Countries*, Policy Brief No. 3, OECD, 1992.

Estache, A., A. Gomez-Lobo. and D. Leipziger, *Utility Privatization and the Needs of the Poor in Latin America*, World Bank, 2000.

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Roger, N., *Recent Trends in Private Participation in Infrastructure*, Public Policy for the Private Sector, World Bank, September 1999.

Shirley, M. and P. Walsh, *Public versus Private Ownership: The current state of the debate*, World Bank Working Paper, 2000.

Trivedi, P., *How to Implement Privatization Transactions*, Harvard University Press, 2000.

Welch, D. and O. Fremont, *The Case-by-Case Approach to Privatization*, World Bank Technical Paper 403, 1998.

2. Identifying the stages of PPI – what is PPI?

Outline of this Module

What this Module does:

This Module describes the different stages of a standard PPI process, beginning with the appraisal of different policy options, and continuing through to contract management. The purpose is to help readers understand the role of advisors at different stages in the process.

Who should read this Module:

All those who require an overview of the PPI process and, particularly, government officials involved in hiring and managing advisors should read this Module. This includes procurement officials in the ministry or privatization unit and their immediate superiors.

This Module presents and discusses the four main stages of a typical PPI reform program. It discusses each stage and provides an indicative timescale for each of the different forms of PPI. Figure 2-1 provides a general overview of a standard PPI program. The four stages are:

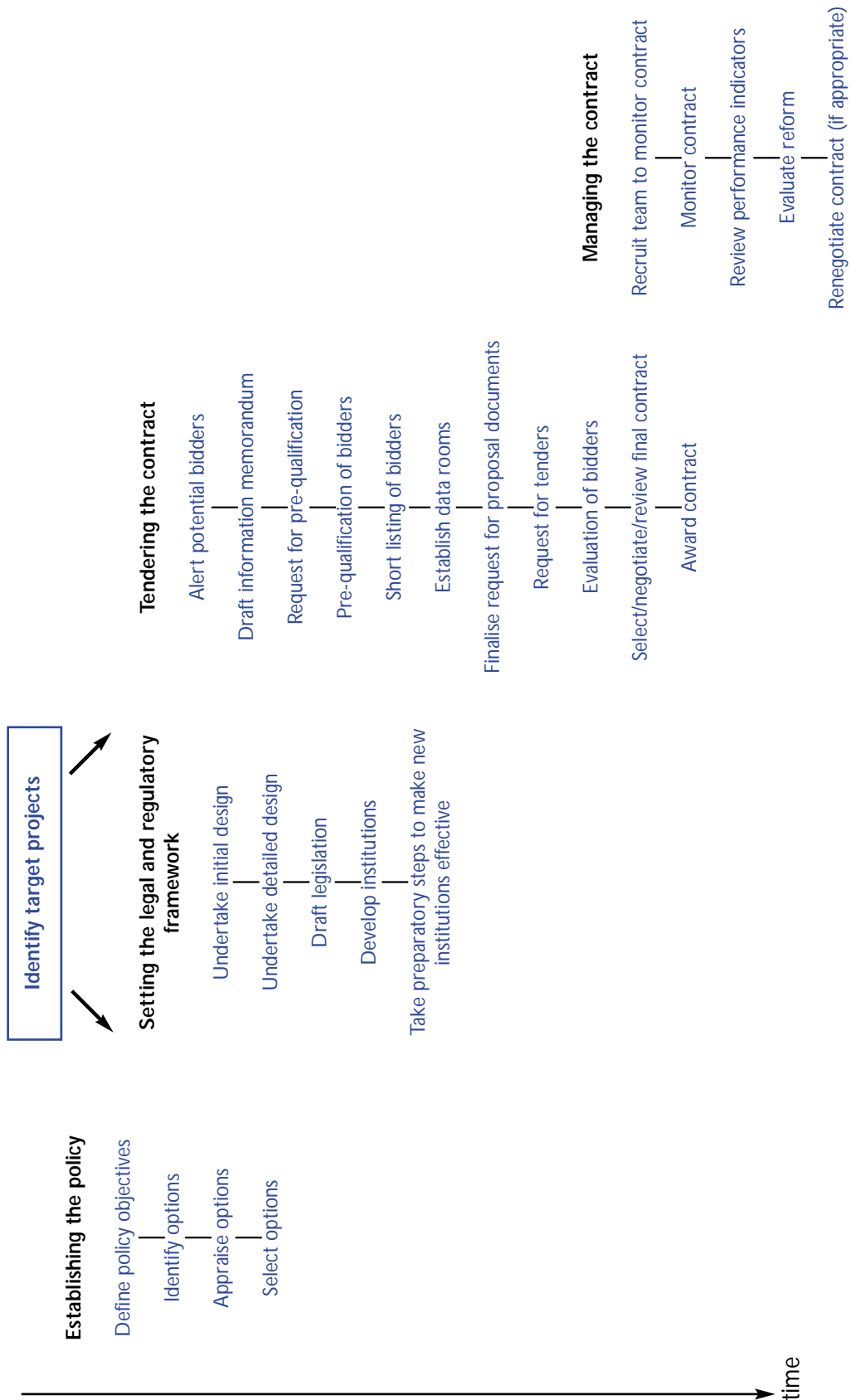
- formulating policy;
- establishing the legal and regulatory framework;
- tendering the contract; and
- managing the contract.

At some point in the PPI reform program, there will be a need to identify appropriate projects in which involvement of the private sector might be sought. The exact point in the process at which this occurs will differ from case to case. Indeed, interest in pursuing a particular project sometimes drives the larger reform process. Therefore, the figures represent this task in a floating box located between the end of stage one and stage three.

Each of the stages of the PPI process varies in importance depending on the form of PPI.

This Toolkit focuses on the hiring of advisors. Therefore, the descriptions of the PPI process are brief, generalized and intended to clarify the role of advisors throughout the process. In practice, advisors should be asked to provide a much more detailed outline of the stages for a particular project when preparing the approach section of their technical proposals. This work plan can be refined once again when the advisor has begun working for the government.

Figure 2-1
Stages of the PPI process



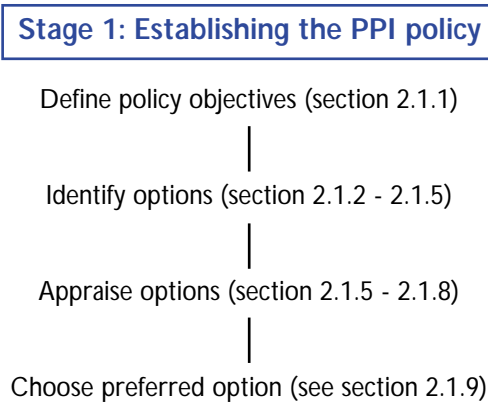
2.1 Stage 1: Formulating policy

The broad policy framework needs to be established before steps are taken to introduce private sector participation. The basic structure to this decision-making process is straightforward. The government:

- defines policy objectives;
- identifies options for meeting them;
- appraises the options; and
- selects its preferred option.

Figure 2-2 illustrates the sequencing of these tasks. This section discusses what they entail in practice.

Figure 2-2
Establishing the policy



2.1.1 Clear objectives are key to the success of policy reform

Successful PPI programs are characterized by a constant referral back to a clear set of objectives that have been agreed by all key government officials and their advisors. Less successful programs fail to ensure that the reforms are developed in line with the objectives, or they have vague and undefined objectives, or different objectives depending on who is consulted.

Having varied or conflicting objectives will create problems. It may create problems when bidders submit their tenders. For example, some government agencies, typically Ministries of Finance and State Property Funds, may favor awarding a tender that meets the objective of revenue maximization; other government agencies, such as line industries or regulators, may favor a tender that minimizes tariff impacts. Discussion on the actual objectives should take place well before transaction documents are prepared. It is essential that objectives are defined at the start, written down in simple summary, and that they form the basis of all decisions.

Objectives will vary. However, most PPI programs have two shared objectives:

- to increase the efficiency of infrastructure industries, by transferring risk from the public to the private sector and through the introduction of competition; and
- to transfer investment responsibility from the public sector to the private sector.

Governments may also pursue a range of other objectives through PPI programs.

These include:

- improving the quality of service delivered;
- expanding service provision to certain geographic areas or to particular sections of the population;
- developing emerging capital markets;
- redefining the role of the public sector;
- focusing on development in a particular part of the country; and
- raising revenue.

Governments have even entered into PPI initiatives in order to slow degradation of the environment. This is common where governments are not capable of financing or operating investments in newer technologies such as desalination projects for bulk water supply, cleaner burning power plants for electricity generation, and more stringent dredging standards for port access channels.

The nature of the government's objectives will have a direct bearing on the alternative form of PPI and the process pursued. Unless objectives are clearly defined and prioritized, there will be no basis for making consistent choices. This will lead to major difficulties with the selection of advisors and the PPI process as a whole. The first step is therefore to prepare a concise written statement of objectives, and to ensure that this forms the basis of subsequent decisions. One common practice is to ensure that all documents produced by the team working on the PPI program start with a short restatement of the agreed objectives. An indicative Statement of Objectives for a PPI initiative is presented below.

Indicative statement of objectives for a port PPI program

The primary objective of this initiative is to increase handling efficiencies in the major general cargo and container terminals of the country, to unblock bottlenecks to trade, and to lower the costs of delivered goods.

This Statement of Objectives emphasizes efficiency gains that can lead to easier trade, and eventual cost savings for consumers. It does not emphasize, for example, the development of capital markets or the importance of raising revenues for the Treasury. As a result, advisors working from this simple Statement of Objectives will focus on approaches to PPI that are intended to increase operating efficiency at the port facilities—through competitive tenders for multiple terminal operators or through performance targets and incentives placed in the bidding documents, for example. The advisor will not seek to structure the process in such a way that it necessarily leads to locally traded shares or to a large cash payment to the government at the time of privatization.

What the Statement of Objectives contains, and what it does not contain, will affect the entire PPI process and approach to advisory services. The relationship between these objectives and the potential for transferring risk is examined in detail in section 2.1.7.

Recommendation 2.1: The government officials responsible for overseeing a PPI program should articulate a clear set of objectives at the outset of an initiative and ensure that all affected government agencies are in agreement on the set of objectives. These objectives should be communicated to advisors at the earliest possible opportunity and should be referred to throughout the process when alternative approaches to PPI and processes for implementation are being considered.

2.1.2 Broad options for meeting the objectives should be identified

Once a decision has been made to go ahead with PPI, and there is a clear view of the objectives that can realistically be achieved, the government will have to consider the main options for PPI. This will be a major and complex decision because the government will also need to decide on the following issues:

- the degree of risk transfer;
- the mechanism for protecting consumer interests – market, contract or regulation; and
- the structure of the industry.

The options for feasible private sector involvement will also vary among projects.

In addition, all elements of the reform program must be consistent. For example, an option that seeks to transfer substantial risk to the private sector should not be combined with a highly prescriptive contract that limits the ability of the new owners to manage that risk; and an option that relies on competition to protect consumer interests should not be combined with an industry structure that gives too much market power to one participant.

2.1.3 Risks should be allocated between government and the private sector

The degree of risk transfer will be reflected in the form of the program. This should be based on analysis of the desirable and feasible level of risk transfer. The forms of PPI range from, at one extreme, service contracts, through, at the other extreme, the sale of assets. Figure 2-1 illustrates the spectrum of approaches.

The main options are:

- **Service contracts (2–5 years)** Private companies are employed for certain narrowly defined and specified tasks (e.g., billing services). The responsibility of the private company is limited to the specified service. The service contract is paid for in a fixed fee by the public authority. The degree of risk transferred to the private sector is limited to the service task.
- **Management contracts (3–5 years)** Management contracts extend a service contract to include the management of the company as a whole, so that management risk is transferred to the private sector. Payment is usually a fixed fee, though a portion of the total value may be covered by a bonus.⁴

⁴ See survey by Shirley and Xu “The Empirical Effects of Performance Contracts” World Bank, Policy Research Working Paper 1919, 1998.

- **Leases (10–12 years)** The private sector operates the system for a given period, but assets remain state-owned. The public sector generally remains responsible for financing new investment, and the private company for working capital and maintenance. The private sector is also responsible for collecting revenue, that it uses to fund its operations, while more risk is allocated to the private sector.
- **Concessions (15–30 years)** The private sector both operates the system and is responsible for new investment for a period of time defined in the concession agreement. At the end of the contract, the concessionaire hands over the system and is paid the residual value of the existing assets. Depending on the existence of government guarantees, the operational, financial and investment risk transferred to the private sector may be commensurate with an asset sale.
- **Greenfield contracts (10 years to indefinite)** Greenfield investment refers to the construction (and potentially operation) of a new project (e.g., a new power plant on a site, a greenfield, that had not previously had any generating facilities on it). When greenfield investment is required a series of other arrangements allows the government to transfer the risk of construction and operation to the private sector. These arrangements are summarized below.

Types of Greenfield investment

The jargon can be confusing! This is a list of the more common abbreviations to describe greenfield investment structures and their allocation of responsibilities.

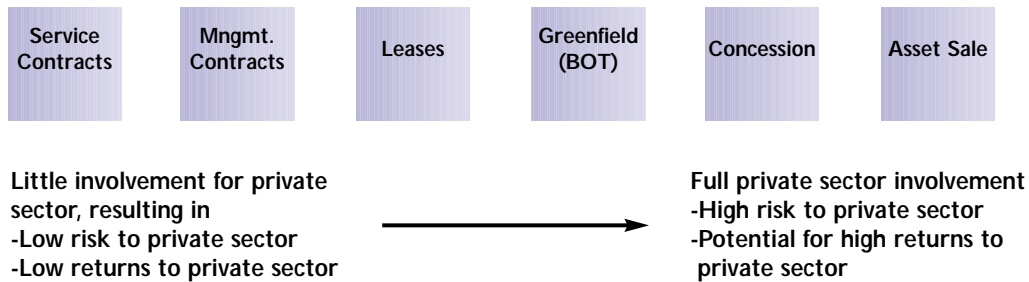
BOT	Build, operate and transfer
BOO	Build, own and operate
BOLT	Build, operate, lease and transfer
BLOT	Build, lease, operate and transfer
DBFO	Design, build, finance and operate
ROT	Rehabilitate, operate and transfer ⁵

⁵ ROT is not a greenfield project but is included in the list because the form of contracts and risks transferred are similar to the other forms of contracts.

- **Asset transfer (indefinite) - trade sale or flotation:** A full asset transfer, whether sold to individual companies or floated on the stock exchange, results in the private sector purchasing the existing facilities. The private sector then has full control over the ownership and operation of existing assets and the construction of new assets without any future obligation to return those assets to the government, or any other party. At the same time, the assets are freely transferable to other private sector institutions.⁶

Figure 2-3

The risk spectrum of PPI options⁷



The degree of risk transfer needs to be consistent both with the objectives and with the overall approach to private sector participation. Where consumer interests can be protected indefinitely through competition, solutions with a high degree of risk transfer may be appropriate. Where the government wants to maintain a loss-making service, a lower degree of risk transfer will be appropriate because the service would simply stop if the private sector fully assumed the risks, unless the operator is subsidized by the public sector.

Recommendation 2.2: The government should structure the contract for sale or services based on an allocation of risks that is consistent with its objectives, and with the overall approach to private sector participation.

2.1.4 It needs to be clear how consumer interests are protected

While government provides infrastructure services, consumers are protected – with varying effectiveness - through the normal processes of government. Private providers will have a strong incentive to maximize profits from infrastructure provision. It needs to be clear how consumer interests will be protected in this new environment.

The simplest and most effective way of protecting consumer interests is through a competitive market. If suppliers fail to meet consumer needs, they will also fail commercially. Many governments have withdrawn from direct provision, and now rely on competition. **Where it is feasible, reliance on a competitive market is by far the best solution.**

⁶ In practice there are many forms of asset sale. Under some conditions the government retains a golden share which allows it to veto certain decisions (e.g., the sale of the assets to another party). This option may be selected either because the government wants to prevent sensitive assets from being sold to particular parties (e.g., foreign ownership of a port also used by the navy) or to prevent potentially anti-competitive activities (e.g., a generation company owning the transmission network).

⁷ This spectrum provides only an indication of the relative allocation of risk; actual project details will affect the true allocation. For example, a concession agreement may result in greater transfer of risk to the private sector than an asset sale if the sale is accompanied by government guarantees for minimum price, revenue or volume of business.

Infrastructure services have often been thought of as natural monopolies. In other words, it is inefficient for several companies to provide a service because of the high fixed costs. This makes competition difficult. The transmission and distribution networks are typically natural monopolies. Both bulk suppliers and retailers need to access them if they are to supply final consumers and it is inefficient to have numerous, overlapping networks. Where one source of bulk supply dominates – the main water catchment, a gas field with substantially lower costs, or a large power station that dominates the market – this also reduces the scope for competition. In transport, regions that have only enough traffic to support one highway or one port terminal must contend with the monopolistic traits of infrastructure, although competition between modes of transport may still be possible.

Where private sector participation is sought in areas of natural monopoly, governments have often relied on regulatory solutions to prevent an abuse of monopoly power. This allows the outright sale of these assets, but makes it clear that their prices will be regulated indefinitely. Typically, the regulator's objectives are set in legislation, but the regulator is given independence and discretion in meeting them. The overall objective – from the investor's viewpoint – is to maximize profit subject to constraints imposed by the regulator, consumers and others.

Regulatory solutions create higher risks than competitive solutions. Investors will be concerned that there will be political pressure on the regulator. Even if there is no direct pressure, regulators may be concerned to protect consumer interests and reluctant to recognize the substantial risks attached to investment. **As a result, regulatory solutions need strong attention to the independence and competence of the regulators.** This is discussed in section 2.2.

A third option is to protect consumer interests through contract. This may be an appropriate option under three circumstances:

- as an evolutionary stage, before regulatory institutions are fully formulated and operational;
- in sectors characterized by short-term, rather than indefinite, operation of infrastructure (e.g., solid waste collection);
- for management contracts where the government is unable to create a suitable regulatory structure.

Contractual solutions may appear to create fewer risks than regulatory solutions because contract law is largely well established, while regulatory law and practice are relatively untried. However, contracts are less flexible than regulatory tools. The longer the contract period, the greater the likelihood that contract management will increasingly adopt similar features to a regulator. The contract's effectiveness breaks down when it is unable to absorb new information, and use that information to reset prices and the obligations of providers.

Where contractual solutions are adopted, performance audit will be an important component of contract management. This will involve establishing realistic but challenging performance targets for the private sector operator and then monitoring the operator's performance to ensure these targets are met.

2.1.5 Industry structure needs to fit with the approach taken

The success of any PPI process depends on selecting the appropriate industry structure. For example, solutions based on competition require that multiple companies supply a service. They also require that the monopoly networks be separated from potentially competitive parts of the industry. Creating multiple companies at one level – e.g., several generation companies or individual airports – is known as horizontal separation. Vertical separation refers to the break between levels - e.g., separating generation from transmission, or airport terminals from runways.

Contractual solutions may have fewer requirements for changes to industry structure. For example, a number of countries have franchised out operation of the power or water sectors as a whole. Public transport may be franchised with the network and the services integrated.

Recommendation 2.3: The approach taken to industry structure should be consistent with the overall objectives, with the degree of risk transfer and with the mechanism used to protect consumer interests.

2.1.6 The options should be appraised against the objectives

Once the options have been identified, they need to be assessed against the objectives. This process is known as appraisal.

The form appraisal takes depends on the objectives. Table 2-1 illustrates a possible appraisal of options for risk transfer, assessed against four objectives. The assessment makes it clear that if the government's main objectives are to improve efficiency and to finance investment, they should seek high degrees of risk transfer. If their main objective is to maintain control of the level of provision – perhaps for political or national security reasons – they may aim for lower levels of risk transfer.

The table is only illustrative. It shows that appraisal requires analysis of how well different options meet objectives, so that the government can choose among them. It is also important that the appraisal takes account of the likely level of market interest: a reform that appears well designed, but which seeks to transfer risks the private sector is unwilling to accept, will not be successful.

Table 2-1
Objectives met by different forms of PPI

Government objective	Service contract	Management contract	Leasing	Green-field	Concessions	Divestiture
Improve efficiency	✓	✓	✓	✓✓✓	✓✓✓	✓✓✓
Transferring investment risk	X	X	X	✓ or ✓✓✓	✓✓✓	✓✓✓
Improving quality of service ⁸	✓	✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
Maintaining control of the service provision	✓✓✓	✓✓✓	✓	X	✓	X

Key: ✓✓✓ to a large extent; ✓ to a small extent; X not usually.

2.1.7 Governments also have transitional objectives...

Governments are likely to have transitional, as well as long-term, objectives. They may need to complete a transaction within a particular timetable – for example, to fit in with the electoral cycle. They will need the objectives to fit within a budget. They are likely to have concerns over regional impacts and the impact on the labor force, even if these are temporary rather than long-term concerns.

The appraisal should also reflect these transitional objectives. Reforms need to be politically acceptable and achievable.

2.1.8 ...and will need to gauge stakeholder support

The successful implementation of PPI programs will require the support of a wide range of stakeholders, from employees through consumers to potential investors.

Assessing investor interest

The government and/or its financial advisors should fully assess the degree of investor interest in a project.

A large element of basic infrastructure is unattractive to private investors. This does not preclude the use of the private sector to improve efficiency in specific areas. An example in the ports sector is a container terminal located at a site suitable as a potential hub port for liner services, but which requires basic infrastructure that does not exist. Bids are sought from international consortia in the (mistaken) belief that an efficient container terminal operation can bear the costs of breakwaters, dredging and reclamation, to provide a navigable harbor and shipping channel. The project fails without securing a deal, after much effort and money have been expended. In such circumstances some degree of public subsidy will be required.

⁸ There is a difference between improving efficiency and improving service quality. Efficiency is defined as the ratio of inputs to outputs. This ratio can remain the same even though the quality of the service changes.

Consequently, an important part of the appraisal will entail assessing the extent to which each of the PPI options will attract support from investors, from the public, and from the government.

Once this has been assessed, the government will need to identify those stakeholder groups whose legitimate interests will be affected by the reform and to establish ways of resolving related conflicts. The government may also need to consider how to build a better understanding of the reform issues (including a willingness to adapt in the face of legitimate stakeholder concerns) and to build support for each of the reform options.

2.1.9 Based on this analysis, the government needs to choose the form of PPI

The appraisal should lead to an approach that meets the government's objectives. Before starting work on the legal framework and the transaction, the government needs to decide the preferred option.

Figure 2-4 presents an illustrative flow chart that outlines the steps leading to the choice of the form of PPI. In essence, the flow chart summarizes the implications of the differing constraints, described in Section 2.1.6, on the choice of PPI.

Each form of PPI is a means to an end and not the end itself. Therefore, the answer to each of the questions depends on two main factors:

- the government's objectives; and
- the characteristics of the assets and sector in question (i.e., the constraints).

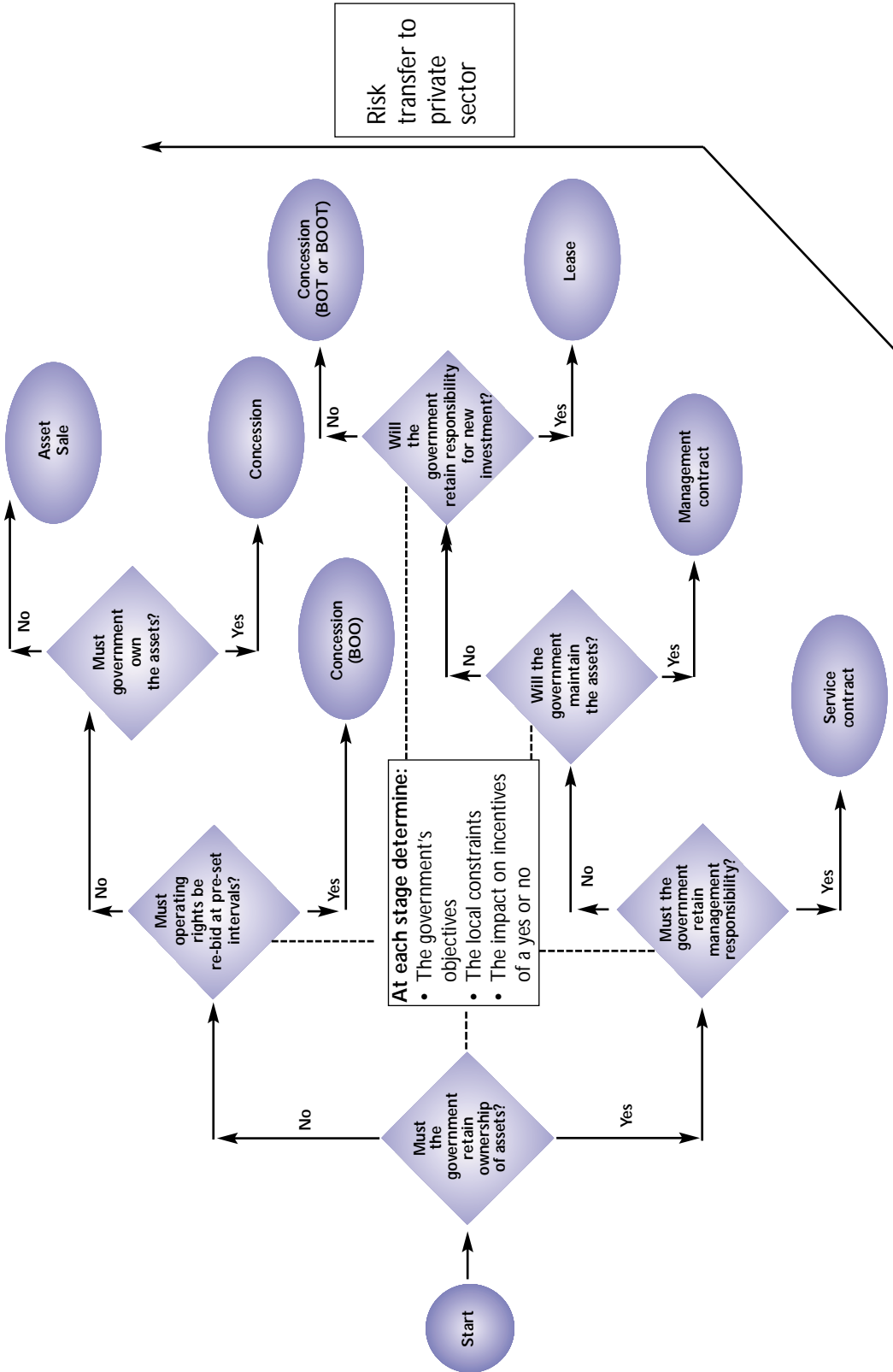
Each country or region will have characteristics that will determine the answers to the questions posed in the flow chart.

The importance of managerial control

Whenever the private sector is asked to incur the operational risk of a company, one of the most important factors potential bidders take into account is the degree to which they will have effective control over the employees. All of these approaches transfer responsibility for company performance to the private sector. However, private operators will only accept this responsibility if they think they have sufficient control in order to meet the requirements set out in the contract or to ensure a return in the case of an equity sale. The most important form of control is often control over employees.

Whether or not each of these forms of PPI is compatible with transferring power over employees depends on the legal and administrative structure of the country in question. For example, in India, where several states have embarked on private participation in the power sector, the current employment contracts in the government-owned companies contain clauses that make it difficult to transfer control over the employees to a private company that does not *own* the assets. Consequently, the ability to use management contracts, leases and concessions to create efficiency gains (and even to attract the private sector) is severely limited. Therefore, states that are currently reforming their power sectors are choosing to go down the route of an equity sale.

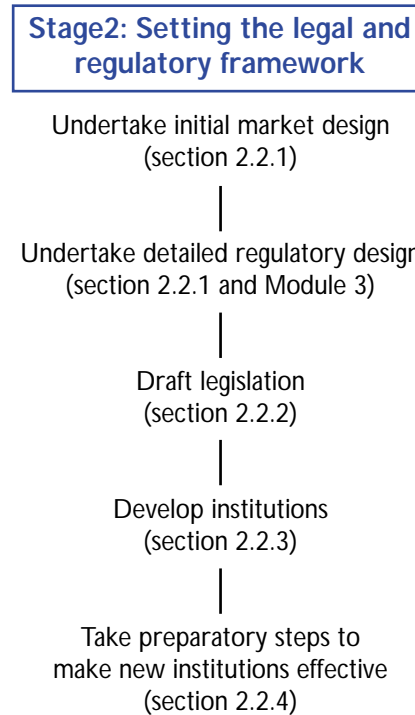
Figure 2-4
 Choosing the appropriate form of PPI



2.2 Stage 2: Setting the legal and regulatory framework

Stage 1 is concerned with choosing the form of PPI. Once this is complete, Stage 2 is concerned with establishing the appropriate legal and regulatory framework for the chosen form of PPI. This involves building on the preliminary analysis undertaken in Stage 1 as part of option appraisal. Figure 2-5 outlines the steps in this stage.

Figure 2-5
Setting the legal and regulatory framework



2.2.1 *The market structure and regulatory framework need to be designed*

Once the policy work has identified a preferred option at a broad level, it becomes necessary to design the appropriate market and regulatory framework. There should be a gradual progression from initial design to detailed design, which can form the basis of legal drafting.

For example, the policy work may have identified a need for privatization of gas transmission, against long-term regulation. Initial design now needs to consider in greater detail which services and assets are regulated: whether prices, revenue or a mix of the two are regulated, on which basis regulated revenues or prices are reset and how frequently, and a series of other decisions.

Similarly, policy analysis may have concluded that there should be a competitive market for wholesale electricity. Market design will now need to consider, for example, whether this applies to all generators, or only to those above a certain size; whether all energy is traded through the pool, or only at the margin; whether there are separate markets for energy and capacity, or whether these are integrated; whether all generators receive the system marginal price, or whether they are paid their own bid price.

During the design stage, advisory inputs need to start with high-level conceptual design before moving towards detailed technical design which can be incorporated in documentation. Module 3 describes the role of advisors in that progression.

2.2.2 Legislation and subsidiary legal instruments are needed

Where assets are being sold into a fully competitive market, there may be little need for specific legislation. General legislation governing consumer protection, property rights and competition law may be sufficient. This will be the case, for example, where a government sells an airline or bus company that is subject to strong competition.

Infrastructure will rarely be as straightforward. Even where competitive solutions are adopted, they will usually rely on specific legislation to establish the market. Where regulation is needed, it may need to be underpinned by legislation.

Once detailed design is completed, work should start on drafting legislation and other legal instruments. The documents required will vary from case to case, but might include:

- the legislation itself;
- licenses, which impose obligations on market participants;
- a code that describes the functioning of the market; and
- a variety of quasi-legal documents establishing the approach to regulation.

Contracts for private sector participation are likely to have fewer requirements for legislation. Contract law will govern the contract itself. The policy objectives of the government can be embodied in the contract.

2.2.3 The main institutions need to be established and developed

It is important that progress is made on the key institutions before a transaction is completed. Private investors will be exposed to decisions made by these institutions and will want to examine their independence, their competence and the extent of their powers. It is far easier to examine these issues once the key personnel are in place and operational practices established.

In establishing a regulator, decisions will be needed on:

- how the regulator's independence is safeguarded – this is likely to be reflected in legislation;
- whether there is a single regulator, or separate regulators for different sectors; and
- whether regulators have national or regional coverage.

Regulators tend to have wide discretionary powers. It is therefore important to balance the regulator's accountability against the discretion it requires.

Contractual solutions may have less need for new and autonomous institutions.

However, an individual or department within government will have to monitor the contract and be the first point of contact for the contracted party.

These institutions will need capable staff. Some can be recruited. A number of countries have attracted nationals working abroad or ex-patriots working in the country to fill regulatory positions. However, most staff will need to be trained and developed.

2.2.4 Preparatory steps should be taken to make these bodies effective

The preparatory steps needed to make these new institutions effective can proceed at the same time as other steps already underway to attract private sector participation.

In many cases asset valuations will be needed

The financial valuation of existing assets is important for the government when PPI occurs through leases, concessions or asset sales. Although the private sector will undertake this on its own account, the government is also likely to undertake the task in order to provide an appropriate benchmark for the sale price, and to form the basis of any regulated tariffs.

The valuation will involve three main steps: first, preparation of an asset register, which simply lists the assets; second, a review of the condition of the assets; and third, valuation of the assets.

The economic value of any asset is the value of the future net cash flows earned by that asset, discounted by an appropriate cost of capital (discount rate).

In practice, valuation can be complex. The estimation of discounted cash flows requires details of:

- estimates of future sales;
- prices and collection efficiency;
- estimates of future operating efficiency and performance;
- estimates of future operating costs;
- estimates of future capital expenditure and sources of financing;
- current levels of debt and debt service costs;
- taxes payable; and
- choice of an appropriate cost of capital.

Asset bases may be valued for accounting purposes in a number of ways. The asset base is often reported in historic cost terms (i.e., the cost of the assets when they were originally installed), in current cost terms (i.e., the cost of replacing the asset base with the same assets today), or in terms of modern equivalent assets (i.e., the cost of replacing the asset base with different, modern assets that perform the same service). The choice of the methodology for valuing assets in different sectors will vary on a case-by-case basis. The results of the various valuations are generally made available to potential investors in a data room (see Module 3).

The private sector will use the information on the various valuations when preparing bids for the concession or assets. In any initial valuation, government officials, with their advisors, will need to assess:

- the current level and standards of service;
- the potential level and standards of service;
- the location and quality of the assets;
- the likely level of demand in the future; and
- the likely level of required investment.

The interaction between the newly valued asset base and the regulatory regime's revenue control has important implications for the provision of incentives to private companies. The design of both the form of PPI and the specific contract in question must incorporate these effects.

Regulatory duties need to be defined

The range of duties the economic regulator will be required to undertake will vary according to the form of PPI introduced. In general, however, the main tasks could include:

- **Price or revenue regulation** This can be achieved through a spectrum of approaches, from price-caps to rate of return to sliding scale regulation.
- **Quality of service regulation** Some form of performance monitoring, as well as price-monitoring, will be required to ensure that standards of service are maintained. Examples of performance indicators include measures of supply interruption for water, gas and electricity; connection time for telecommunications services; and regularity of service for transport.
- **Ensuring security of supply of services** Services provided by energy, water, transport, waste and telecommunications companies are all necessities to some degree. While major consumers may negotiate security of supply, most consumers are exposed to a common quality. The regulator needs to set this.

There may be a need to design tariffs

Where government is entering a contract, it needs to design a tariff for the services it is purchasing. For example, a contract for a water supply plant will need to determine the tariff against which the operator is paid. Where government is supporting a loss-making service – for example, a public transport franchise – it will need to determine the tariff that applies to final consumers.

In many cases, tariffs can also be set through a competitive bidding process. For example, a public transport franchise could define the quality of service required and seek bids for the lowest tariff required. Alternatively, bids can be let on the basis of the lowest subsidy required to supply services at a given tariff. Even then, some room should be left for innovation, and for the introduction of tariffs that may give consumers new options.

The appropriate structure of tariffs will need to reflect:

- the degree to which tariffs require regulatory oversight;
- the extent to which it is both desirable and appropriate to charge customers differently;
- the desire to meet wider social policy concerns through tariff design; and
- the extent to which prices should provide incentives to both consumers and suppliers.

Where tariffs are regulated, the form of regulation needs to be clear

In addition to the tariff design, decisions must be taken on how tariffs will be regulated. This is particularly important in the context of full or partial divestiture of assets. Options for regulating prices range from rate of return regulation to price cap regulation.

Under rate of return regulation, the regulator places a limit on the returns earned by invested capital and may also place restrictions on the dividends payable to share holders and on accumulated capital reserves. Under price cap regulation, the regulator limits price increases, often by a certain amount below inflation over the regulatory period⁹. This approach entails the regulator assessing, on a forward looking basis, the likely levels of capital and operating expenditure over time, and potential efficiency increases.

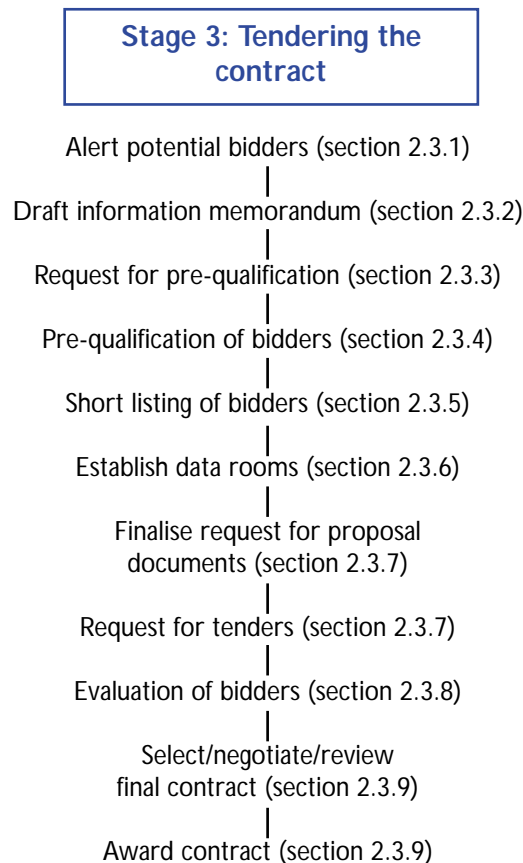
Recommendation 2.4: Government officials should prepare drafts of the documentation required to establish the legal and regulatory framework required before the transaction. These drafts should be sufficiently advanced to convince potential investors that they will be implemented.

⁹ See Further Reading, Vickers and Yarrow (1998), at the end of this Module for a full description.

2.3 Stage 3: Tendering the contract

The third stage of the PPI process should end with the government selecting a private sector partner. As illustrated in Figure 2-4 a successful transaction depends on a number of intermediate steps.

Figure 2-6
Tendering the contract



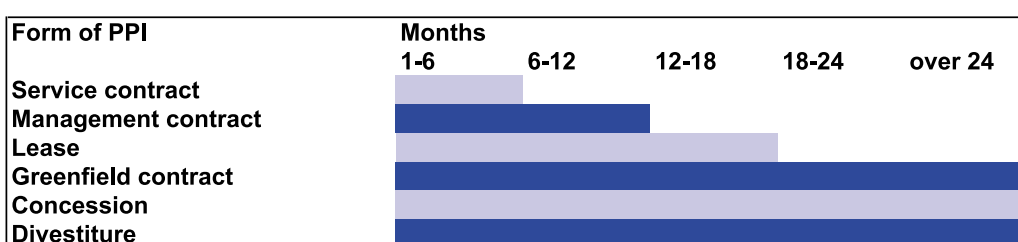
The timetable for these steps will vary according to the form of PPI chosen. The award of a management contract should be completed over a relatively short period compared to the award of a 20-30 year concession. Figure 2-7 illustrates some indicative time profiles for the implementation of different forms of PPI (see Module 4 for more detail). The profiles are only intended as a guide to the time required to agree and implement a contract. The exact time needed will vary by country and by sector. A country that has all the relevant legal and regulatory frameworks needed for a successful divestiture in place will require less time to flotation than a country with no such structures in place. The valuation of assets or design of tariffs may take longer in some sectors than in others. As a country introduces more private sector participation, the time taken to complete transactions is likely to fall.

Asset valuation in the water industry

One difficulty with valuing assets in the water industry is that much of the distribution infrastructure – trunk mains and local pipe networks – is old and underground. This can make it very difficult to locate, let alone value, the assets. Past hyperinflations and currency devaluations will also impact on valuations. Various methodologies are available, including sampling techniques and leakage estimation, to estimate both the extent and condition of the network. Even so, asset valuation in the water industry can take considerably longer and is subject to greater uncertainty than in other infrastructure industries. This uncertainty could have implications for the length of time required to implement a PPI transaction.

Figure 2-7

Indicative timetable for reform



Note: See Module 4 for more detail

2.3.1 Potential bidders need to be alerted to the opportunity

As part of the appraisal of options, government officials or their advisors will have undertaken a preliminary survey of potential investors, which will have raised investor awareness of the proposed reform. However, a more extensive promotion is needed as the transaction draws near.

Before starting the bidding process, informal discussions may be useful to determine whether the investors invited to participate in the pre-qualification stage are the most appropriate ones. Pre-bid discussions can also provide useful information on what can be done to attract favorable bids.

Information can be disseminated through pre-bid conferences and the international and national media. In all cases, all potential bidders should receive the same data and material, so that no potential bidder has additional information that may help it win the contract.

Finally, large PPI transactions frequently include international roadshows to ensure investor interest. The role of public relations consultants in this process is discussed in Module 3.

2.3.2 An information memorandum should give bidders detailed information – and drafting should start early

The information memorandum will set out what the government hopes to achieve and how, the scope of the proposed project and what is to be delivered. The better the information made available to bidders, the higher the bid quality. Given the importance of the information memorandum, drafting the relevant documents should begin early in the PPI process.

This requires an upfront decision on the allocation of risks between the government (or the public representatives) and the private sector. This decision partly depends on the PPI option chosen and partly on the specific risks associated with the project in question. Table 2.2 outlines these risks in more detail. The table should only be treated as a guide: whether risks can be transferred, and whether it is appropriate to transfer them, will depend on specific project circumstances. In all of these areas there are international examples which can be adapted and from which lessons can be learned. However, there are no off-the-shelf solutions. As a result, progress towards detailed design will need to draw on both international experience and analysis of the situation within the country concerned.

An information memorandum is a much more in-depth description of the company to be privatized or PPI project than that provided in the request for proposals¹⁰. Because financial advisors are usually hired to market a particular transaction, they are often responsible for preparing the more detailed document and for presenting the transaction in the most favorable light (see Module 3 for details on financial advisors). The information memorandum does not only report facts; it also analyzes them and presents the various possible scenarios. In other words, financial advisors complete some of the due diligence most of the serious bidders will do themselves, thereby increasing the chances of attracting high quality bidders.

Lexicon of bidding terminology for investment

Advisors – individuals, companies or consortia assisting the government with the PPI process. Bidders may also seek assistance from outside advisors.

Bids – the price and detailed documentation that each bidder submits in response to a request for proposals

Bidders – individuals, companies or consortia competing for the PPI contract

Contractors – usually, those companies providing building or construction services

Consultants – see Advisors

Data room - a single location containing commercially confidential information that bidders may need in the course of preparing their bids

Financial close – Point at which all the conditions of the financing agreements have been met, all the finance is available and the contract becomes effective

Financiers – all lenders or potential lenders providing debt for a project

Information memorandum – document provided to shortlisted potential investors covering relevant financial, legal and technical information

Investors – entities or individuals participating in the equity and/or subordinated debt of project companies set up to implement projects

Offering memorandum – documents that provide details of assets to be sold to investors

Preferred bidder – sole bidder selected after the bid evaluation process to commence negotiations aimed at concluding a signed contract

Roadshow – series of meetings held in different locations aimed at promoting an investment opportunity to potential investors

Strategic investor – an investor with operating experience in the sector who intends to purchase a large or controlling share in the equity of the project company for a substantial period of time

Special Purpose Vehicle (SPV) – project company set up to implement projects

Suppliers – companies or individuals providing goods or raw materials

Tenders – see bids

¹⁰ Also known as the requests for tenders or the invitation to tender documents.

Table 2-2
Risk identification and allocation in project financing

Risk	Nature	Allocation	Mitigation
Design risk			
Design mis-specification (I)	Design does not meet request for proposal (RFP) specifications	Construction company	Construction company has responsibility for designing and building contract to specifications.
Design mis-specification (II)	Design fault in tender specification	Public sector	Public sector bears any resulting cost increases
Construction risk			
Construction cost overruns	Due to actions within construction company's control (e.g., wastage)	Construction company	Fixed-price contract and use of liquidated damages (LDs) payable by construction company
Completion delay	Due to actions within construction company's control (e.g., lack of co-ordination of sub-contractors)	Construction company	Use of LDs payable by construction company
Failure to meet performance criteria at completion	Quality shortfall, defects in construction and other faults	Construction company	Use of LDs payable by construction company. Once exhausted, project company bears costs
Operating risk			
Operating cost overruns	Change in operating practices at request of project operator	Project company	Project company returns eroded
Changes in price of inputs	Increased prices for fuel supplies, labor and other inputs	Party best able to control or bear risk	Use of hedging at supplier or project company's expense, pass-through to consumers

Table 2-2: (continued)

Risk identification and allocation in project financing

Risk	Nature	Allocation	Mitigation
Non-delivery of inputs	Failure to supply fuel and other inputs of sufficient quality or quantity	Supplier	Supplier pays costs of sourcing alternative supplies and any compensation due to consumers
Demand (I)	Variation of demand from forecast levels, for reasons beyond control of government	Project company exposed to both increases and decreases in demand.	Risk spread among financiers; investment in a range of project diversifies risk.
Demand (II)	Failure of predicted demand to emerge for reasons within control of government	Public sector	Contractual protection against interventions which reduce demand
Commercial risk			
Tariff changes (I)	Changes in market prices	Project company	Project company returns eroded
Tariff changes (II)	Failure to implement contractual changes in tariffs	Public sector	Public sector compensates project company for deviation from contracted levels
Tariff changes (III)	Change in demand arising from tariff adjustment by company	Project company	Must analyze revenue changes from impact of tariff changes on demand

Source: Frontier Economics and Submission and Evaluation of Proposals for Private Power Generation Projects in Developing Countries, IEN Occasional Paper # 2, World Bank and USAID, 1994.

2.3.3 Bidders may be asked to prequalify

Request for proposal documents should be disseminated to enough suitably qualified potential investors to ensure sufficient competition, but not so many that it is difficult to evaluate all the proposals. One way of ensuring this is through the process of pre-qualification, beginning with requests for Expressions of Interest (Eoi).

One method of requesting expression of interests is by placing advertisements in appropriate trade journals or other publications. Placing advertisements on the Internet may also be an option. The advertisements should contain a description of the potential investment opportunity. They should also invite potential bidders to make themselves known with evidence of their suitability by a certain date.

2.3.4 Only well qualified bidders should be let through

The potential investors or operators who have expressed interest in the project and provided the requested information should be evaluated against the minimum standards set for technical capability, financial and economic standing and ability. Officials can devise tests aimed at profiling suitable bidders and assessing their financial strength and/or technical capabilities.

The purpose of this stage is to assess whether bidders are capable of submitting a bid, and whether risks to government, including financial risks, can be adequately managed. It is not intended to substitute for detailed financial proposals for the particular project.

There is an argument that pre-qualification and the derivation of a shortlist may not be necessary. This argument suggests that in general, potential investors will only bid if the investment is worth their while and therefore will not submit bids if they are unable to carry out the necessary functions. However, in practice, governments often want to ensure that bidders have minimal technical competence and use shortlists to eliminate firms without the required technical abilities or financial strength. Pre-qualification also provides a mechanism for screening out speculative bidders, that would, if their proposals were taken further, waste time and money.

To maintain the integrity of the process, these tests, once passed, should not be revisited. Officials should not re-evaluate the shortlist unless new information emerges that casts doubt on the original assessment.

By evaluating the information supplied and applying a minimum standard to all respondents, officials will arrive at a list of bidders who qualify for consideration in the next stage of the process. Shortlisting will result in a list of companies that are invited to submit formal bids (possibly after further data-gathering). If no shortlisting takes place, all respondents are free to submit a final bid.

2.3.5 If there are enough bidders, a short list of qualified bidders can be prepared

A pre-qualification exercise will produce a list of qualified candidates who pass the minimum standards. In some cases, officials will wish to invite all of these bidders to take part in the competition.

However, in other cases, the list of pre-qualified bidders will contain more parties than can be sensibly accommodated in the subsequent tender process. Officials may

streamline the list if they are in a position to score the relative merits of the bidders' competence, and so rank them and select the required number from the resulting list. If they follow this route, officials should institute an objective and fair scoring system based on the published criteria. They should also inform any bidders not taken forward why they were not selected. Providing a limited short list may also increase the interest of those shortlisted because it increases their chances of winning.

2.3.6 Data rooms should give all bidders access to sensitive information

The purpose of the data room is to make available to potential bidders commercially confidential information that they need to draw up their bids.

What is a data room?

A data room is a single restricted-access location, usually in the country where the investments will be made, containing commercially confidential information that bidders may need to prepare their bids. The types of information the data room contains will include the results of technical audits and evaluations, financial information, environmental and ground studies, traffic or other nuisance studies, land ownership details, current relevant laws, and information on human resource issues.

The data room will need to be staffed to ensure security. Visits should be by appointment only to preserve the confidentiality of interested bidders. The legal advisor can organize this process.

Given the difficulties of collecting data relating to assets in some infrastructure industries, it is worthwhile starting this process as early as possible in the PPI program.

2.3.7 Final request for proposals should be sought

The documentation requesting final proposals must be clear and informative. It should outline the minimum information required for any assessment of the potential bidder's economic and financial standing and technical capacity, and the criteria for award. The information memorandum or the letter accompanying the request for proposals should include the full information requirements needed for the assessment.

In addition, bidders may need further access to the data room and may be expected to conduct more detailed due diligence at this stage.

In some cases potential bidders have been required to purchase the request for proposal documents. This can be used to demonstrate the seriousness of the potential bidder and to cover a portion of the costs of the PPI process.

2.3.8 Bidders should be evaluated

Officials will need to evaluate the bids received in accordance with the principles and criteria set out in the invitation to tender documents. It may be necessary to prepare questionnaires for each evaluator to use as a basis for marking the proposals. The project team will need to establish procedures for transparent communications with bidders and document control in order to maintain the integrity of the evaluation process.

The following issues must be addressed prior to the evaluation of the bids (i.e., when the bidding process is being developed).

- Are both technical and financial bids required (and, if so, how should they be weighted?) or only financial bids?
- Is a technical benchmark to be used with all of those who clear it evaluated solely on a financial basis?
- How are technical or financial bids that are innovative and meet the government's objectives but do not comply with the original invitation to tender to be evaluated?
- If multiple contracts or equity participation are being bid, how are multiple bids to be evaluated?

2.3.9 Contract award and post-evaluation negotiations

There will be a few remaining tasks to be completed after the contract has been awarded.

Government officials will need to negotiate and, depending on the form of PPI, sign a series of contracts with the project participants. Detailed schedules on the project documentation will need to be completed, drafting issues resolved and financing documentation put in place. Various government guarantees, such as the guaranteed availability of foreign exchange, may be required.

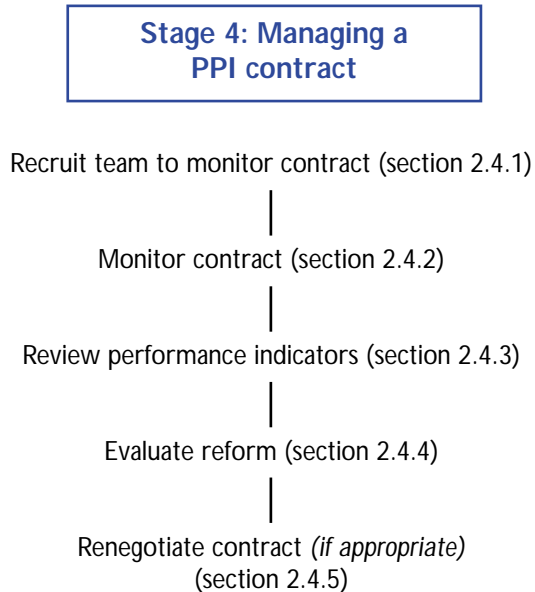
These post-bid processes can be lengthy and sufficient time must be allocated for them. Detailed contract negotiation is also the stage at which the security arrangements for the government, embodied in the contract, become clear. For this reason, it may be necessary to negotiate contracts with several bidders until there is confidence that an adequate contract can be agreed with the preferred bidder. However, this is unpopular with companies because it increases the cost of their bid.

Recommendation 2.5: The government should manage the transaction stage and the bid criteria transparently, to avoid the possibility of decisions being challenged at a later date.

2.4 Stage 4: Managing a PPI contract

When a government enters into a contract, whether this is a concession, a BOT or a lease, it will require active contract management. Transactions that rely on competitive markets or an independent regulator will have less need of government involvement in management once the transaction is complete.

Figure 2-8
Managing a PPI contract



Contract management involves ensuring that the respective roles and responsibilities set out in the contract are fully understood and met to the standards laid out in the contract, in order to fulfil the government's overall objectives. Part of the contract management process will involve establishing procedures and the institutional units to monitor the contract, and taking appropriate action where contractual obligations are not met.

The exact range of tasks in stage 4 of the PPI process will depend on the form of PPI chosen (e.g., if divestiture has been chosen these steps do not apply). It will also depend on whether there is an independent regulator and, if there is, the exact range of tasks allocated to it.

2.4.1 Establish contract management team

Irrespective of the final terms and conditions included in the contract, some form of contract monitoring will be required to assess whether the private sector provider is providing the appropriate range of services to the agreed standard. This may involve the appointment of an auditor to verify company records and accounts or to monitor and test operational performance.

To ensure continuity, some of the government officials who worked on the early stages of the PPI process should continue to monitor the performance of the private sector provider. This may involve a transfer of staff from the sponsoring department

to the independent regulator. Where this occurs, it may be appropriate for some officials to be retained within the sponsor department to liaise with, or shadow, the regulatory agency.

2.4.2 Monitor contract

In some circumstances, the contract will specify the relevant performance indicators against which the contractor will be judged. However, it may be necessary for the contract management team to develop these indicators to ensure that the contractor meets its contractual obligations fully.

2.4.3 Review measures

During the course of the contract there should be a review of the key performance indicators. A common problem with the use of performance indicators is that they can provide incentives for the company to distort its behavior and it may be important to evaluate whether this is taking place.

The problem of distorted incentives

A common performance indicator included in a service contract for the provision of customer services for a utility is the proportion of customer telephone calls answered within a minute. But this may provide incentives for the operator to answer calls quickly but to put customers on hold before he or she has dealt with the query. Similarly, performance measures established for train operators such as the number of trains running an hour or more behind schedule could provide incentives for train operators to cancel certain services altogether.

While the use of good performance indicators should circumvent these problems, no set of performance indicators, however comprehensive, will be able to overcome the phenomenon completely. Contract monitoring must therefore include an awareness of the potential for the provider to game the established performance criteria.

2.4.4 Evaluate contract

Once the contract has come to an end, an evaluation of the reform should assess whether it has been successful in reaching the government's objectives, as defined in stage 1. Independent auditors may have a role to play, by assessing the extent to which the private sector provider has adhered to levels of service and quality obligations.

2.4.5 Renegotiate contract

Once the contract is close to completion, the government will need to consider the process of re-appointing private sector providers unless it decides to take the asset back into state ownership. Contract re-negotiation may also be required in the event of pre-determined or agreed changes in circumstances other than that of the contract running its course.

Recommendation 2.6: Governments should set aside significant resources for successful contract management, particularly where it is required to replace or complement independent regulation.

2.5 Variations from the standard PPI process

Figure 2-1 and the discussion in Sections 2.1 to 2.4 provided a general overview of the different steps that contribute to each of the stages in the PPI process and an indication of the sequencing of these steps within each stage. However there are a number of circumstances in which variations to the standard PPI process might occur.

2.5.1 Due to the form of PPI selected

Figure 2-9

Variations from the standard PPI process

Establish legal and regulatory framework	Service	Mgmt	Lease	Green	Concess	Divest
Undertake initial and detailed design	Required					
Draft legislation and other legal instruments	Not nec		Required			
Develop institutions	Maybe					Required
Preparatory steps	Required					
- Tariff design	Required					
- Value current assets	Not nec		Required			
- Define regulatory duties	Not nec		Maybe		Required	
- Draft regulations	Required					
Key	Not nec		Maybe		Required	

Depending upon the form of PPI selected the overall timing of the process, beginning with the policy formulation and ending with contract management, will vary. A service contract will be relatively easy and quick to introduce, whereas a full-scale privatization through asset sale may take many years to complete (see Figure 2-7).

The form of PPI will also have an impact on the steps within each stage, because not all the steps will be equally relevant. The introduction of a service contract will rarely require the government to pay significant attention to the issue of the state of the assets, compared with, for example, a transaction leading to privatization through a concession or sale of assets. In particular, the importance of the tasks in stages 2 and 3 depend on the form of PPI under consideration. Figure 2-9 illustrates the extent to which the specific tasks might be needed under different models of PPI.

2.5.2 Sector specific considerations

The specific form of the PPI process will also vary according to the sector under consideration. For those officials seeking sectoral information related to market structure, regulation and the role of the private sector, the sector specialist in the donor agencies working in a given country will be able to provide them with relevant material. One starting point for background information and contacts would be the web-sites of the donor agencies identified in Module 6.

Alternatively, Toolkits and Guides have been developed in recent months to cover the sector-specific processes for PPI in several infrastructure sectors (water, solid waste, ports, and highways). A brief description of those Toolkits, including contact and ordering information follows:

Toolkit for the Private Participation in Water and Sanitation

The World Bank's Toolkit on Private Sector Participation in Water and Sanitation is designed to assist policymakers with three key sets of issues:

- how to choose a private sector participation option;
- how to design the process for refining and implementing the chosen option;
- how to ensure that contracts for private participation in the sector (specifically, management contracts, BOTs and concessions) cover all the relevant issues.

Details on how to order hard copies of the Toolkit from the World Bank bookstore can be found at: (<http://www.worldbank.org/html/extpb/howtoorder.htm>)

The Toolkit can also be viewed on-line at:
(<http://www.worldbank.org/html/fpd/wstoolkits/>)

Guidance Pack on Private Sector Participation in Municipal Solid Waste Management

This publication is designed for municipal officials who are using, or considering using, private companies or commercialized municipal organizations to provide solid waste services.

The *Pack* comprises five separate booklets:

- *Executive Overview*
- *Part II*: description of potential benefits and implementation issues arising from a privatization process.
- *Part III*: overview of the various arrangements for involving the private sector, including checklists, forms, and terms of reference.
- *Part IV*: comprehensive definitions and explanations of specialized terms that are used in Parts II and III.
- *Part V (electronic format)*: sample contracts for both collection and disposal, and select tools from Part III.

This publication has been prepared with the support of the Swiss Agency for Development and Co-operation and The World Bank. It costs £18.50 Sterling plus postage and is available from:

Intermediate Technology Publications Ltd.

email: orders@itpubs.org.uk

Tel: 44-171-436-9761; or Fax: 44-171-436-2013

Toolkit for Private Participation in Highways

This Toolkit, currently under preparation, is expected to guide policy makers through the process of assessing and electing specific public/private partnership options for delivering essential road and highway development-related functions and for assuring the safe, efficient and high quality delivery of services that are responsive to user needs.

In this regard, the Toolkit will:

- Illustrate available reform alternatives.
- Delineate the core and value adding services which modern highway authorities offer.
- Analyze the different possible forms of private sector involvement in the delivery of each type of service.

Particular attention will be paid to ensuring that appropriate economic incentives and regulatory constraints exist to maximize social welfare.

For information on how to obtain the Toolkit, please contact PPIAF (www.ppiaf.org).

Ports Reform Toolkit

The purpose of the Port Reform Toolkit is to provide policy makers with effective decision support in undertaking sustainable and well considered reforms to public institutions which provide, direct and regulate port services in developing countries. In particular the purpose of the Toolkit is to provide public officials with support in:

- understanding the needs, challenges and risks for sector reform and institutional redesign which are emerging from the changing business environment surrounding port operations;
- choosing among options for private sector participation and analyzing their implications for redefining interdependent operational, regulatory and legal relationships between public and private parties;
- preparing legislation, contracts and institutional charters to govern private sector participation;
- managing the transition to increased private sector involvement.

The Port Reform Toolkit will be available on the World Bank Internet site, under the Transport webpage, in March 2001. A CD-Rom is expected to be available by September 2001. Information for ordering the Port Reform Toolkit CD-Rom will be available on the World Bank Transport homepage:
<http://www.worldbank.org/html/fpd/transport/>.

For specific questions on the Port Reform Toolkit, please email Marc Juhel of the World Bank's Transport Division at Mjuhel@worldbank.org.

2.5.3 Sole-sourcing may be appropriate under limited circumstances

Sole-sourcing provides investors with incentives to approach the government with innovative ideas. It is less expensive and much quicker to implement than a competitive tendering process. It may also be an appropriate option where there are relatively few companies operating in a particular market and their track records are well known.

However, sole-sourcing of infrastructure projects also has substantial disadvantages. Sole-sourced projects do not provide the government with an opportunity to evaluate the technical or financial merits of alternative bids. They therefore leave the government exposed to costly mistakes and criticisms of non transparency. Even if the government manages to extract all possible cost savings from its sole-source contractor,¹¹ the lack of transparency may result in a perception that this is not the case. This may lead to court challenges, and opposition from other politicians and the public, all of which could delay the project and increase its cost.

¹¹ A doubtful proposition since the company to whom the work will be sole-sourced is likely to be better informed about the true cost of the project than the government.

Finally, sole-sourced contracts create wide scope for corrupt practices and are consequently regarded with suspicion by most donors, governments, companies and other industry participants.

When deciding whether sole-sourcing is an appropriate way forward, government officials will need to balance the costs and benefits of doing so on a case-by-case basis.

Unsuccessful sole-sourced projects

Maharashtra, India

In the early 1990s an agreement to build a 2000 MW power plant was signed with a private developer on a sole-source basis after the government decided to forgo international competitive bidding. However, in the following elections, opposition parties criticized the scheme based upon the fact that the process was not transparent. Whether or not the scheme did provide value for money became a secondary issue. Instead, all sides were able to level numerous accusations that resulted in the project being tied up in the courts for years.

2.5.4 Unsolicited bids can be incorporated into the PPI process

Because of the reasons outlined, a purely sole-sourced approach is useful only in very limited conditions. In general, pure sole-sourcing may be useful if the project is small and follows previous good experience with the company or individual concerned, and/or the timetable for reform is tight.

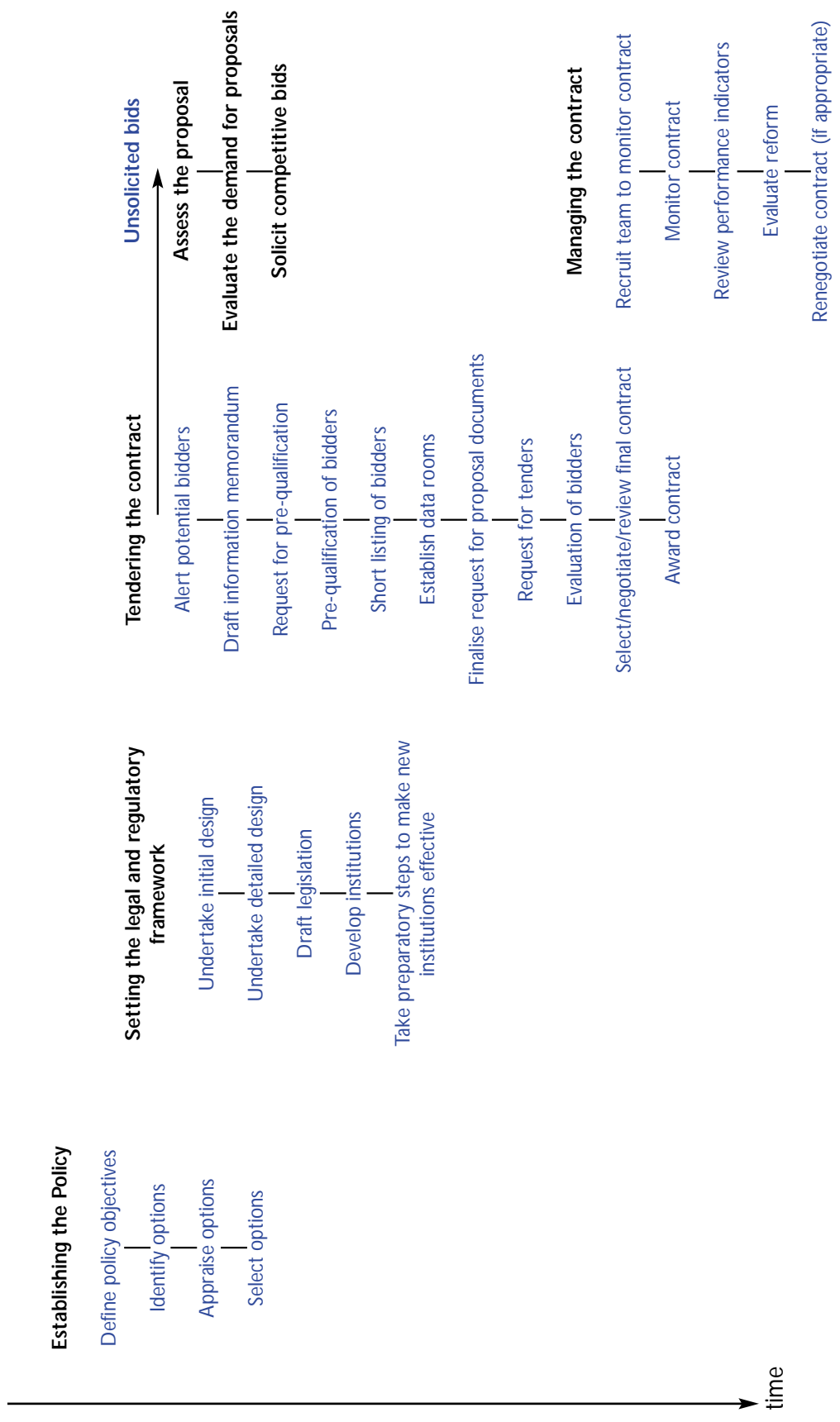
However, if the government does not acknowledge suggestions for new projects arising in the private sector, then it risks losing one of the most important functions of PPI—its ability to generate new ideas. If companies are not rewarded for bringing new ideas to the government (i.e., if the government simply implements its standard competitive bidding procedure when a company approaches it with a new idea) then there are few incentives for companies to suggest new ideas. Consequently, a number of countries have implemented competitive bidding schemes that reward the company originating the idea. Figure 2-10 illustrates how unsolicited bids are incorporated into the PPI process.

2.5.4.1 The Swiss Challenge system

The Swiss Challenge system is designed to attract new ideas from the private sector while ensuring that they are priced at appropriate levels. A generic outline of the steps involved in this process follows.

- (1) **Bid receipt** A government committee first reviews any suggestions for a new PPI project. It determines whether the initiative has merits worth pursuing and, whether the proponent has the technical and financial capacity to provide the service. If it does, the government may enter into negotiations with the party that suggested the new services.
- (2) **Negotiations** The negotiations have two main aims: first, to outline a concrete proposal, with clear outputs and a timetable, and to find a price initially acceptable to both parties. The outcome of this process should be a clear proposal outlining exactly what is to be done and at what price. The negotiations themselves should be subject to a pre-set timetable; lengthy negotiations would be costly for all the involved parties.

Figure 2-10
 Incorporating unsolicited bids into the PPI process



- (3) **Advertising** Once the negotiations for the services are completed, the government publishes the details in a government procurement publication, on the government website, in local or international newspapers, and/or in other appropriate media. In general, the advertisement should include a clear outline of the services along with the final negotiated price.
- (4) **Swiss Challenge** Following the advertisement any other company is invited to submit a proposal, prior to a deadline that provides companies with adequate time to respond.
- (5) **Resolution** If none of the new bids scores higher than the original bid (or if no bids are received) then the contract is awarded to the original party. If one or more of the new bids is judged to be better than the original bid, the original team has a pre-determined period in which to respond. Its response must be based purely on reducing the price they offered. If it manages to meet or better the best of the new bids, then the contract goes to the original bid; otherwise, it goes to the best scoring new bid.

This system provides companies with considerable incentives to propose new ideas. If they are able to propose a sufficiently innovative idea, it is unlikely that other companies will be able to submit a better proposal. At the same time, it protects the government from making expensive mistakes if the idea is not specific to the originating company and other companies are able to provide the services at a lower price.

An example of Swiss Challenge

In 1997 the Philippines government approved an unsolicited BOT proposal for a new international terminal at the main international airport in Manila. After approving the idea in principle and negotiating a price, the government put the proposal to a Swiss Challenge. Following advertising, a new consortium submitted a proposal that provided the government with more revenue from the terminal than the original proposal. Consequently, the new bid was awarded the project.

Note: This is also a cautionary tale because the original proponents stalled the project's implementation by taking the government to court, claiming that the winning bid, while providing more revenue to the government, does so only by changing the technical specifications of the project. This is why it is important that challenges only be allowed to challenge on the basis of price. Technical bids must be comparable.

Source: World Bank,

2.5.4.2 The Chilean Bonus system

Chile has implemented extensive PPI programs, from private toll roads dating back to the 1960s to restructuring and privatizing its power sector - one of the first countries in the world to do so. Consequently, it was quick to recognize that the private sector could be a useful source of ideas, while also understanding the benefits of competition. Therefore, the government developed a system that rewards the company that proposes a new idea while maintaining the competitive process in the award of the contract. The process is outlined below.

- (1) **Suggestion:** Any company wishing to submit a proposal for a new project must complete a government form in which it outlines the general concept of the services without providing specific details.

- (2) **Preliminary evaluation** The relevant ministry (in Chile, the Ministry of Public Works) then evaluates the suggestion. If it is rejected, the proponent is free to re-submit a modified bid. If it is accepted, the proponent must submit a more formal application within a specified deadline.
- (3) **Detailed submission** The detailed submission must fully identify the company or companies proposing to undertake the work, a justification for the services and full details of how it will be undertaken.
- (4) **Secondary evaluation** The same ministry then has a specified length of time (in Chile, one year) to evaluate the detailed proposal. If the proposal is rejected, the consortium retains intellectual rights over the idea for the next three years in order to ensure that the government does not simply reject good ideas and then implement them itself. If the idea is accepted then it is put to a formal competitive bidding process.
- (5) **Competitive submission** The proposed services are advertised and any interested parties—including the original proponent—are invited to bid for it. The government rewards the original company for the idea with bonus points. (In Chile it was originally rewarded a 20% bonus, subsequently reduced to 10%.) If the original proponent either loses the bid or decides not to participate, the winning bidder must compensate it for the cost of developing the original idea. The amount of the compensation is specified in the bidding documents.

Unlike the Swiss Challenge system, the Chilean Bonus system forces all companies to go through a formal competitive process, including the original proponent. However, to provide incentives for companies to come up with new ideas it awards the proponent with a bonus. It also has a mechanism to ensure that the government does not simply steal good ideas, by guaranteeing intellectual rights if the idea is rejected before the competitive bidding phase.

Successful Chilean Bonuses

By the end of 1998, three of the five contracts for private sector operation of Chilean airports had been awarded through this mechanism. In each case it was the private sector that approached the government with the suggestion for the project. In these cases, the competitive process was based on the departure fee charged to each passenger using the airport. The companies that suggested the projects were to be awarded the contracts if their departure fee was within the bonus range (i.e., 20% or 10%, depending on the airport) of the lowest competitive bid. In two of the three cases the original proponent received the contract, while in the third one of the competitive bidders was awarded the project.

Source: World Bank

Useful reading

Vickers, J. and A. Yarrow, *Privatization: An Economic Analysis*, MIT Press, 1998.

Meyer, C and J. Vickers, "Profit Sharing Regulation: An Economic Appraisal" in *Fiscal Studies* (1996), vol. 17, no. 1 pp. 83–101.

Shirley and Xu, *The Empirical Effects of Performance Contracts*, World Bank, Policy Research Working Paper 1919, 1998.

3. The role of advisors – how can they assist?

Outline of this Module

What this Module does:

This Module describes the different types of advisors that may be used to provide technical assistance. It outlines both their general job descriptions and their roles within the PPI process and identifies the main outputs that different advisors will typically produce. In addition, the Module addresses the use of local advisors and the use of advisors by the private sector. It follows the same outline as Module 2, describing the use of advisors for each stage of the PPI process.

Who should read this Module:

Officials who are responsible for drawing up the terms of reference for advisors and who will subsequently select and manage the advisory services should read this Module.

3.1 When to appoint advisors

As a general rule, advisors should be brought on board at the beginning of the policy formulation stage, Stage 1. Decisions taken at an early stage can affect the success of a program, and can be costly if they are not based on correct advice.

However, some approaches to selecting advisors will take time. In particular, international competitive bidding may increase the time required (see 'How to select and manage PPI advisors'). Therefore, appropriate lead times should be built into the process to allow for the selection and appointment of advisors.

Recommendation 3.1: The government should bring advisors on board as early as possible in the policy formulation process. Doing so may save money later on.

Formulating the policy

When to appoint advisors

At the start of the process during stage 1, the policy formulation stage, advisors experienced in providing high-level or strategic advice will be the main source of the expertise required. Preliminary assessment of the issues that will be considered in more detail in stage 2 will also require some input from specialist advisors.

Defining the legal and regulatory framework

Stage 2, defining the legal and regulatory framework, will require significant input from advisors. If certain stages need to be accomplished by predetermined dates, the workloads may be intensive.

The inputs from advisors beyond the first stage can only be determined at the end of stage 1 and they should only be contracted up to that point. The terms of reference for advice beyond stage 1 can be drawn up once the requirements are clearer. Those hiring advisors should make it clear from the outset that appointment during stage 1 provides no guarantee of re-appointment during stage 2 and beyond.

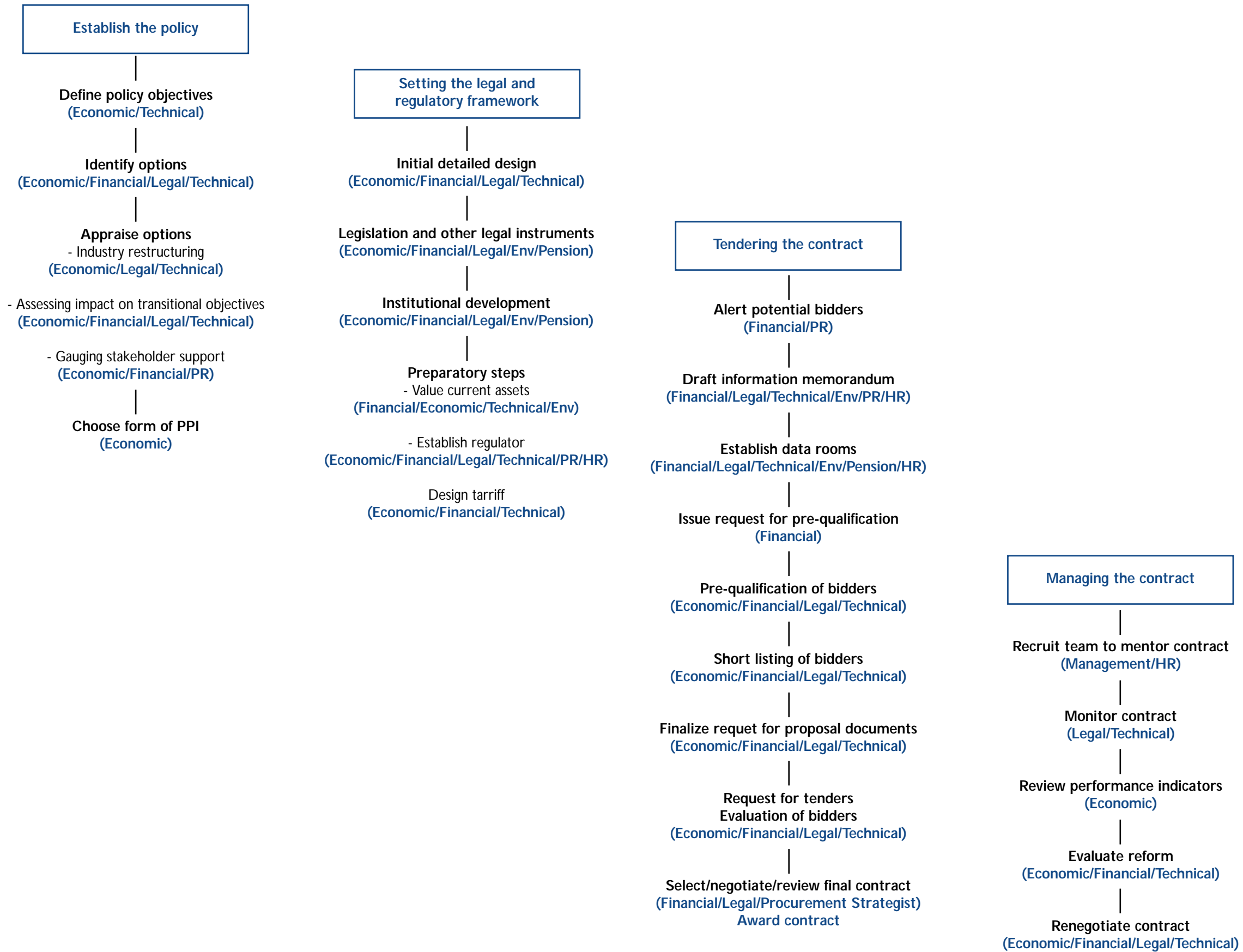
Tendering the contract

Stage 3, tendering the contract, will also require significant input from advisors. As stage three progresses, the role of economic and technical advisors will probably diminish, although lead advisors, financial advisors and lawyers may be retained to assist with the negotiation and reviewing of final contracts. Legal expertise will also be required to draft or review the final contracts.

Managing a PPI contract

The role of advisors in **stage 4** varies considerably, depending on the form of PPI. It may involve monitoring performance, reviewing the contract and providing support on price reviews

Figure 3-1
Roles of Advisors in the PPI process

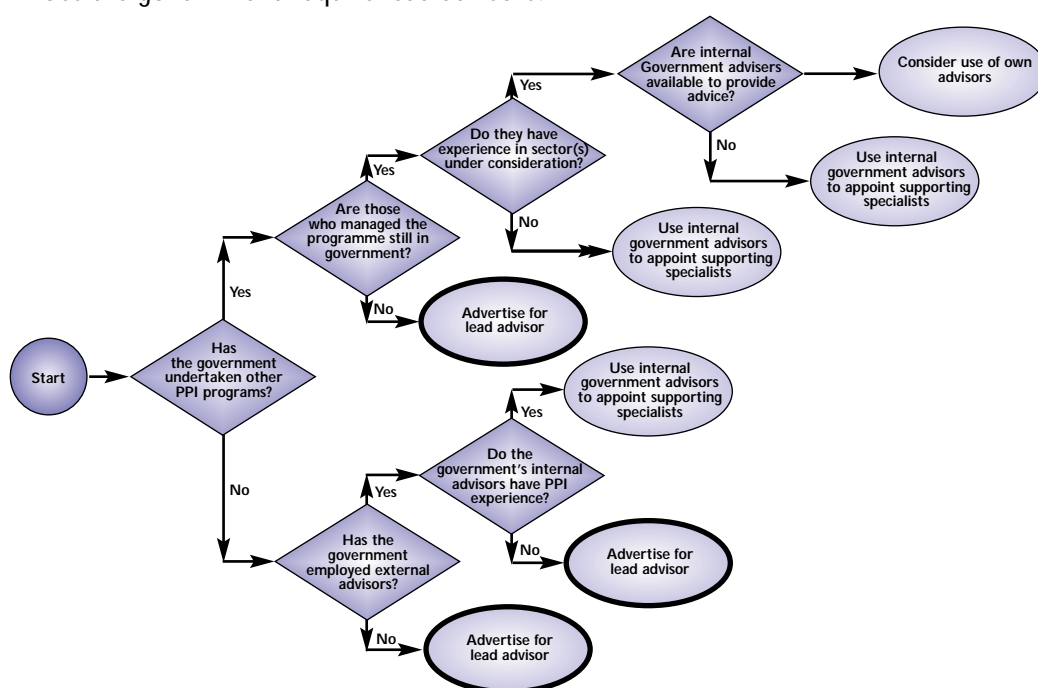


3.2 Lead advisors

Infrastructure projects are usually large and expensive. As a result, an inexperienced government beginning such a process without advisors risks incurring large, unnecessary costs. Whether lead advisors are necessary depends on the degree of government experience in PPI and in the sector under consideration. This decision is summarized in Figure 3-2. Other factors that may also come into play include:

- the size and complexity of the project;
- the available capacity within the government to handle the process;
- the extent to which the government can afford the cost of lead advisors; and
- the ability of donor and other agencies to fill the monitoring and advisory role undertaken by lead advisors.

Figure 3-2
Does the government require lead advisors?



Recommendation 3.2: Officials should decide at the beginning of stage 1 (the policy formulation stage) whether the benefits of appointing lead advisors will outweigh the costs.

Management consultancy companies and the large financial services companies may be called upon to serve as lead advisors. These companies put together multi-disciplinary teams to undertake a number of the tasks within the PPI process. In this role they oversee the process and try to ensure consistency over time between its various components. They will generally sub-contract tasks requiring specialist advice (see Section 3.3), although the government will still have to contract directly for most of the sub-components of the PPI advisory services.

Lead advisors tend to be brought into discussions at an early stage of the PPI process, usually at the policy formulation stage, where they are required to provide strategic advice on, for example, the range of realistically achievable objectives through specific forms of PPI. They also have a role in guiding officials through the PPI process once

the policy direction has been chosen. Given this role, there is substantial potential for scope creep—for the lead advisors to artificially inflate either their role in the project or the size of the project.

The main characteristic of lead advisors is that they usually have experience of all of the broad issues associated with the different stages of the PPI process and that they are fully experienced in PPI and the sector in question.

3.2.1 How can lead advisors help?

Lead advisors may provide a variety of services, depending on the nature of the PPI being considered.

- **They may advise on the form of PPI.** This involves identifying the range of constraints on governments in meeting their objectives and providing strategic advice on the most appropriate form of PPI given these constraints, all within an overall procurement strategy.
- **They may undertake preliminary feasibility studies.** This involves identifying the obstacles to a specific policy or project and making a preliminary assessment of whether these obstacles can be overcome.
- **They may help to design the implementation process and timetable.** This involves establishing the main tasks to be undertaken and assessing how long each will take, building contingencies into the timetable where appropriate.
- **They may advise on the selection of consultants for subsequent stages.** Identifying the broad range of subjects where advice might be required is usually straightforward; however, there is often a range of less obvious areas where advice may be needed, e.g. industrial relations, pension advice and insurance provision. Lead advisors will also be able to recommend an appropriate number of companies to be placed on the short list, give advice on the suitability and sustainability of different consortia, and suggest an appropriate evaluation methodology for assessing companies.
- **They may manage the implementation of the technical assistance program.** This will involve co-ordinating and briefing other consultants. Most importantly, it will ensure that the different advisors communicate with each other and present an internally consistent framework for PPI.

Table 3-1
Advantages and disadvantages of lead advisors

Advantages	Disadvantages
Lead advisors can provide the government with expertise on a wide range of issues, thus reducing the possibility of costly mistakes.	Lead advisors can be costly. If paid on a time and materials basis, lead advisors will have an incentive to provide much advice as possible to maximize their revenues.
Lead advisors can identify the range of areas where specialist input is needed. This task can often be difficult for governments that have not been involved in PPI in the past.	Lead advisors will have an incentive to limit out-sourcing of specialist tasks, even though they may not be the most suitable company to undertake the work.
Lead advisors can recommend specific firms to be included in the shortlist.	Lead advisors may be excluded from providing advice in the future in that sector because they have been so heavily involved in the provision of advice to the government at a critical stage in the industry's development.

3.2.2 Selection of lead advisors

The selection of lead advisors is made difficult by the lack of experience in government. It is under these circumstances that donors¹² may be of help. Their international experience makes it likely that they will know which advisors are appropriate to the role (see *Volume II*).

In general, lead advisors should have experience:

- in the sector under consideration, both as an organization and as individuals;
- of implementing PPI projects in the sector under consideration;
- of selecting and, possibly, managing other advisors; and
- of providing high-level advice to governments.

Module 7 in *Volume III* provides a step-by-step guide for a competitive selection process.

3.3 Differing types of expertise needed to guide officials through the PPI process

This subsection outlines the role of different types of expertise required during each stage of the PPI process. Different types of expertise can be found in different types of companies. However, of paramount importance is that requests for advisors identify the skills required of the winning company or individual, rather than merely specifying a particular type of company, individual or number of years' experience.

The key skills needed by governments involved in PPI are:

- economic (see sections 3.4.1, 3.5.1, 3.6.1 and 3.7.1);
- financial and accounting (see sections 3.4.2, 3.5.2, 3.6.2 and 3.7.2);
- legal (see sections 3.3.1, 3.5.3, 3.6.3 and 3.7.3);
- technical (see sections 3.4.4, 3.5.4, 3.6.4 and 3.7.4);
- public relations (PR) (see sections 3.3.5 and 3.6.5);
- human resources (HR) (see section 3.5.5, 3.6.6 and 3.7.5);
- environmental (see sections 3.5.6 and 3.6.7);
- pension/insurance (see sections 3.3.8 and 3.5.7) ; and
- procurement (see sections 3.3.9 and 3.6.8).

3.3.1 Economic

Relatively few companies offer purely economic advisory services, although a number of the larger accountancy companies and a few merchant banks have specialist divisions of economists. Some engineering advisors also employ economists.

Economic advisors understand the impact of different choices (e.g., over industry and market structure, and regulatory systems) on the incentives of the stakeholders (including consumers, private participants and the government). They are likely to have a substantial involvement in advising the government over most aspects of PPI because most decisions have an impact on the incentives of stakeholders.

Economic consultancy skills

Market description

Relatively few companies only offer economic consultancy services. It is more common to find economic advisors in specialist divisions within larger multi-disciplinary companies such as management consultancies. A number of the larger financial services companies that offer a wider range of services also employ economists.

Ownership structures

There is no single type of economic advisory firm. Many of the larger management and accounting companies, set up either as partnerships or public limited companies, have a division that provides economic advice. Other specialist economic consultancies tend to be privately owned.

Organizational structures

Irrespective of the ownership structure, most economic advisors will tend to work in either single disciplinary or multi-disciplinary teams comprising a partner or director, project manager and junior support staff. They may be organized according to sectoral expertise (e.g., energy, transport and health); type of client (e.g., commercial and government services); or even by geographic area of focus. However, it is common for junior and mid-level staff to be pooled and shared accordingly.

Incentive structures

Economic consultancies are usually paid on a fixed fee or time-and-materials basis. The provision of advice is expensive because of the skills and experience involved. The cost of economic advisory services is high compared to engineers or accountants, although it is generally lower than that of lawyers and investment bankers. See Module 4 (Table 4-3) for indicative comparative costs for different types of advisors.

The skills available

Economic consultants understand the impact of differing choices (e.g., over market and industry restructuring, or regulatory systems) on the incentives of the stakeholders (including consumers, private sector participants and the government). In particular, they are able to advise on industry and market structures, design of the regulatory framework and appropriate transition arrangements. Their greatest involvement is most likely to be in the contribution to the design of the reform process, including industry structure, form of PPI and regulation.

3.3.2 Financial

There are many types of companies that are likely to respond to an advertisement for a financial advisor:

- merchant or investment banks;
- accountants;
- management consultants; and
- economic consultants.

Financial advisors have the skills and experience to ensure that the final transaction (whether it is an asset sale or concession or other form of PPI) represents value for money and an affordable and deliverable deal for the government. Their input will vary considerably, depending on the form of PPI. It is likely to be minimal for a management contract but substantial for a large asset sale. Along with the government itself, they will be the primary contact for potential investors.

Generally, an individual working as a financial advisor should have two or more of the following qualifications:

- a first degree in accountancy, finance or a business-related subject;
- a Masters degree in Business Administration;
- a professional qualification in financial and/or management accountancy; and/or
- project finance/ PPI banking experience.

Financial advisors

Market structure

Increasingly, the provision of financial advice by international banks is driven by a desire to be the lead advisor of the financing. Because of the high overheads and competitive revenue risks, few banks are willing to provide project finance/PPI advice as a stand alone facility. Most merchant and investment banks tend to provide advice only on relatively large deals on which they are able to earn substantial fees. These banks may also be involved in advising the public sector as an entry strategy to the PPI market. Other companies that may offer financial advice include management consultancies and some engineering companies. In the privatization of state-owned assets, management consultants and large accountancy firms have challenged the merchant or investment banks with some success.

Ownership structures

Ownership structures vary according to whether financial advisory services are provided by international banks or management consultancies. Investment banks tend to be either publicly-listed corporations or partnerships while traditionally management consultancies

have usually been partnerships.

Organizational structures

Bank structures are usually hierarchical, leading up to director level. Each director has supporting assistant directors and managers. Analysts with a wide range of skills support these. The directors report to a managing director. Management consultants have a similar structure but are often partnerships.

Incentive structures

Financial advisors' fees are usually based on a retainer, which may be calculated on a mixture of fixed or time-and-material basis and success fees. The latter demonstrates their commitment to the project, while the former recognizes that success is not fully within their control. Advisors involved in the sale of state assets are normally recompensed by success fees, which are much higher because of the greater risk involved. An alternative to a single fixed fee is a retainer paid monthly for ongoing advice.

Financial advisors from banks or management consultancies often have a bonus arrangement in their employment package, based on individuals' or the company's results. When providing transaction advice that could lead to a success fee for the firm, individual bonuses may be tied to the success of the transaction as well.

The provision of project finance or PPI advice is expensive because of the required skills and experience. Experienced practitioners are highly paid and there is a shortage of top quality advisors, so competition is also high. Their office overheads are generally high because they are often located in major financial centers with high rents. They also require costly support.

The skills available

International, merchant or investment banks have the skills to structure finance packages, prepare financial plans, analyze risk and structures, prepare cash flow program models, and assist with the negotiation of both legal and financial documentation. They also have the expertise to value state-owned assets when these are to be privatized. When selling equity or bidding out concessions in former state-owned institutions, they must be able to attract a wide range of bidders by having a strong distribution capability – usually the preserve of merchant or investment banks.

Management consultants have similar skills but may lack experience of preparing the financial structures because they lack lending expertise. They may mitigate this by subcontracting individuals with banking experience or by showing the options for financial structures to lending banks which may be involved in the bidding stage.

Financial advisors should have the skills to have a good understanding of the commercial logic and market feasibility of the project, to be able to carry out risk analysis and to prepare the financial structure for the type of PPI being implemented.

3.3.3 Legal

Legal advisors will need to be involved throughout the PPI process and will have an important role from the very beginning of the program. They can help to develop policy objectives by outlining the possibilities for PPI within the existing legal framework. Legal advisors will remain involved during the term of the successful bidder's appointment by assisting in contract management and advising on any variations to the contract or disputes that arise during the term of the contract.

Legal advisors

Market structure

There are several types of legal advisors: large companies with local offices in many countries, smaller companies with offices in a few countries and specialist companies with one or two offices.

Ownership structure

Law companies operate as partnerships. They vary in size from single practitioner companies to those with up to 3,000 employees.

Organizational structures

Most companies will be divided into sector-specific departments (the most common being corporate, banking, litigation, and property). In some companies (particularly larger international companies), there will be more specialist departments dealing with energy, telecommunications, and construction and other infrastructure industries.

The skills available

Law companies provide legal advisory services ranging from regulatory review to drafting and advising on contracts. The range of services they offer includes advising on policy objectives (together with other advisors). In particular, they will identify any legal or regulatory restraints to implementing the policy objectives; review and draft legal and regulatory frameworks relevant to the specific sector; advise on the establishment of regulators; draft contracts, concessions, lease agreements and licenses; and provide advice on pre-qualification processes and the evaluation of bids.

Incentive structures

Law companies usually provide their services based on time-and-material contracts with hourly rates. However, those involved in donor-sponsored work often enter into fixed-fee contracts.

When appointing legal advisors, it is vital to ensure that they have the appropriate skills. Government officials will need to check whether the company has the necessary expertise to undertake the work, although most large practices will have regional specialists with the requisite skills.

Legal advisors specializing in commercial law will be useful for some tasks, e.g., advising on the commercial structure of a new entity. Local lawyers will also be needed for some tasks (see section 3.9), e.g., interpreting and amending local laws, regulations and decrees.

3.3.4 Technical

Technical advisors¹² include those with engineering and related specializations (e.g., architects) who understand the physical aspects of the infrastructure sector under consideration. They should be knowledgeable about the particular sector and be able to advise on operational and investment needs as well as the technical aspects of regulation, legislation and evaluation. It is important that technical advisors have specific and geographically wide-ranging experience of the particular sector they are advising on. Technical advice, by its very nature, relates to the specifics of the proposed infrastructure facility, drawing on experience from previous projects and problems encountered. Whereas a lawyer or a management consultant will advise on the basis of rules and practice generally applicable to all sectors, specific sector knowledge is a prerequisite for good technical advice.

Depending on the government's role in the proposed project, the technical advisors may be required to:

- undertake preliminary analysis to establish the approximate capital costs plus the technical specifications or operating standards needed to achieve the government or public sector sponsor's objectives;
- analyze the possibility of breaking up various elements of the industry (e.g., dividing distribution networks, splitting radio spectrum);
- prepare a drawdown schedule covering the construction period, estimated annual operating and maintenance costs, and estimated project lifecycle costs; and
- review any cost estimates that currently exist as part of a feasibility study.

The estimates need to be prepared to the detail and level required to allow bidders to decide whether they are interested in the project. The bidders would then be solely responsible for undertaking their own due diligence relating to these estimates (and other matters). For further details on how the bidders will use advisors throughout the PPI process, see section 3.10 in this Module.

Technical/engineering advisors

Market structure

Technical companies normally fall into two categories: those that specialize in a limited number of disciplines and those that are multi-disciplined. The former are more common. The specialist consultants usually vary by sector (transport and traffic planning, rail, water and waste water, environmental and solid waste, power and energy, oil and gas, bridges and building structures, road design and construction, marine and ports, industrial and process engineering, mining) and by skill (civil and structural engineering, process engineering, nuclear engineering, project management). With a few exceptions, technical companies are relatively small in size measured in terms of capital or turnover.

Ownership structure

Traditionally technical companies were partnerships, but many have been corporatised as they have increased in size.

¹² In the USA, Architectural and Engineering companies also provide engineering and technical expertise. These are not discussed as a separate category of firm as they provide skills which overlap with more general engineering and technical consultancies.

Organizational structures

These companies tend to be divided by discipline (e.g., design, construction and project management,) with divisions often split geographically or between home country and overseas. There is normally a corporate management core, or center, separate from the divisions, which contains the central management to which the divisions report. Each division is responsible for its own profitability.

Incentive structures

Engineering consultants usually provide their services on a lump-sum or time-and-materials basis. It is very unusual for success fees to be utilized. There may be some form of bonus linked to time. Project management services may be priced based on the number of personnel involved.

In general, technical advisors have relatively low cost structures, especially in comparison with legal and financial advisors. Their overheads are relatively low because salary levels are lower, and their main offices are usually located in low-cost locations.

The skills available

Engineering consultants provide a range of skills and services, including general and architectural design, costing and quantity surveying, planning and traffic studies, technical feasibility studies and reviews, lifecycle costing and analysis, and project monitoring and management.

Some of the larger US and UK consultants have branched out into providing supporting financial advisory services and establishing investment companies which can, on occasion, invest in the equity of project or concession companies. Some of the larger US companies also provide architectural and engineering services separately from their consultancy services. Outside the US, such consultants are usually independent.

The four main skill sets of economic, financial, legal and technical advisors are supported by a number of more specialist advisors. These are described below.

3.3.5 Public relations

Public relations specialists play an important role throughout the process. The introduction of PPI requires change on the part of many stakeholders. This is inevitably difficult and the reasons for the changes, the costs and the benefits, must be carefully explained to government officials, employees, the public and, possibly, the international investor community. Effective public relations experts can save a lot of time, effort and money by bringing the various groups into the process and ensuring that they support, rather than try to oppose, the process.

Two types of PR activity will need to be undertaken. The first concerns the general publicity surrounding the overall reform program. This might include:

- issuing consultation papers to inform stakeholders and the public of the purpose of PPI and the direction of government policy;
- organizing ministerial interviews with the media;
- placing articles explaining PPI in the press; and
- organizing seminars with opinion makers and stakeholders.

The other type of activity PR consultants may need to consider is the promotion of specific projects. This activity will be focused towards generating potential investor interest and may include:

- organizing roadshows geared towards the investor community; and
- surveys of investor sentiment aimed at gauging the level of interest in the project.

The Brazilian experience

In the mid 1990s, when the Brazilian government embarked on the process of privatization of the electricity industry, the government's consultants brought together a panel of nearly 200 technicians from different sectors, ministries and the bank in charge of the asset sale. Working with this group, the consultants identified 34 problems requiring further consideration. These problems were subsequently discussed in working groups.

As a result, a wide range of stakeholders was informed about the process and the government was able to adjust the process incorporating stakeholders' views.

3.3.6 Human resources

Human resource advisors should be specialists in the internal processes and organization of institutions. In addition they should have expertise in designing training programs, skills transfer and the appointment and dismissal of personnel. More generally, there may be a need for detailed restructuring of the existing workforce, pension funds and in some cases, negotiations with trades unions.

There are multiple labor and human resource issues that will confront the government and investors throughout the PPI process. A detailed treatment of these challenges and possible responses is being prepared in the form of a Toolkit.

Currently under preparation, the Toolkit on Labor Issues and PPI aims to provide practical tools and information to help policy makers deal with labor issues in PPI. Drawing from experiences around the world, the Toolkit will serve to identify, promote, and disseminate best practice so as to help governments in developing countries design and implement labor programs and thus also build capacity in this challenging area.

The Toolkit will consist of the following modules:

- Overall context for dealing with labor in PPI;
- Labor approaches and options; and
- Management of the labor restructuring process.

The Toolkit will be finalized and published during 2001. Please contact PPIAF (www.ppiaf.org) for information on how to obtain the Toolkit.

3.3.7 Environmental

Many infrastructure projects have severe, permanent effects on the environment and are therefore likely to require some form of environmental assessment. While the winning bidder will undertake much of this, environmental advisors may be needed in the initial stages to establish minimum environmental standards for bidders to adhere to in their bid proposals. These standards will depend on the sector in question but may, for example, relate to the use of renewable fuels, air quality levels and waste disposal standards. Table 3-2 identifies some sector specific environmental concerns.

Table 3-2
Some environmental impacts by sector

Sector Impact	Power	Water and sanitation	Solid waste disposal	Tele-communications	Transport
Air quality	Sulfur dioxide emissions leading to acid rain		Emission of gases (nitrates) from landfill sites and incinerators		Carbon monoxide, carbon dioxide and particulates from road vehicles
Water quality	Contaminated water from cooling of plant	Waste disposal in seas and rivers			Toxic particles in bays and rivers from dredging
Local disamenity/noise	Power plants	Smell from sanitation plants	Road congestion around waste disposal sites	Effects of telephone masts and satellite dishes	Road congestion; rail crossings
Natural resource depletion	Use of fossil fuels	Abstraction of water and loss from leakage			Contaminated dredge spoils
Global warming	Carbon dioxide emissions				Carbon dioxide emissions

Environmental advisors are employed either by niche environmental consultancies or by generalist management, economic and engineering consultancies.

3.3.8 Pension/Insurance

Some human resource specialists will have this expertise, making hiring a separate advisor unnecessary. However, in the absence of this expertise, an individual or company specializing in these issues could save the government considerable time, effort and possible court costs as they plan for a labor retrenchment.

3.3.9 Procurement strategy

Procurement specialists may design a procurement strategy to reflect the overall goals of procurement, timescales, budgets, financing rules, local legislation and institutional capacity.

The discussion in this section provided an indication of the range of tasks governments will require specific advisors to undertake throughout the PPI process. However, there are few tasks that require a single expertise; therefore the selection of a team of advisors that has the right balance of skills is also important.



The different roles in each stage of the PPI process of all main advisors are summarized in Table 3-3 to Table 3-6¹³. The table also provides an indication of the relative importance of each of the advisors in contributing to each task. Although the relevant type of advisor will largely provide the different types of expertise, in some areas there will be some overlap between the different types of advisors and the skills that they offer.

The shading indicates the degree of involvement of the advisor in question—darker shading indicates greater involvement, with the darkest indicating the lead advisor in that area.

¹³ Note that these tables show the range of tasks for which specialist input might be required, but not their sequencing or timing.

3.4 The role of advisors in stage 1 - policy formulation

In this and the following sub-sections, areas where government officials should expect specific outputs from their advisors are denoted in the text by the following set of icons which are placed to the left of the text.

A	Analysis or advice (often provided as a presentation)
R	Report
M	Model (technical or financial)
D	Draft documentation
T	Training
	Icons with multiple borders (e.g., ) indicate outputs produced by advisors that are submitted directly to government officials ; those with single borders, (e.g., A), indicate outputs produced by advisors that form an input to the work of other advisors .

Stage 1

Figure 3-3
Advisors used in stage 1 – policy formulation

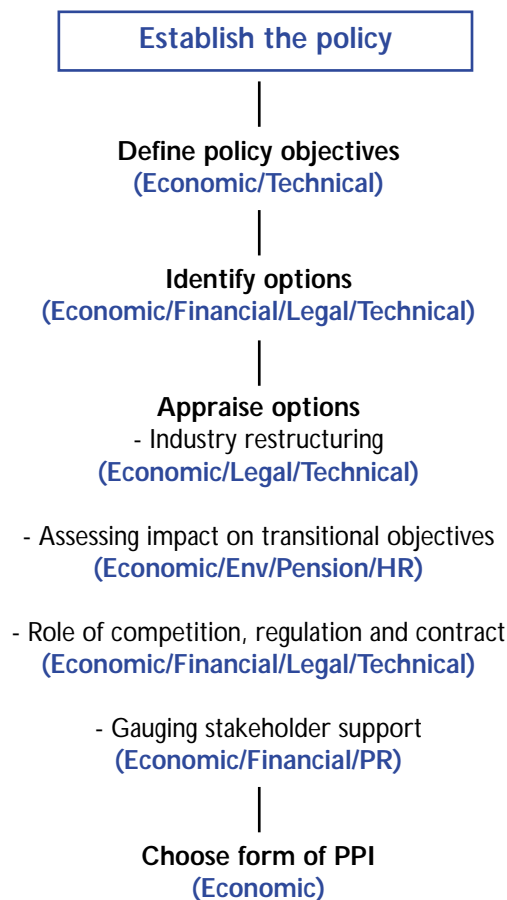


Table 3-3
Role of advisors in stage 1 – establishing the policy

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Defining policy objectives	Can provide advice on the range of objectives that might be achieved under different forms of PPI and the trade-offs between them			Can provide technical details if increasing investment is one of the objectives of the reform					
Identifying policy options	Will establish the feasible range of forms of PPI, forms of consumer protection and industry restructuring, given the set of desired objectives	Can provide advice on the financial feasibility of policy options	Can provide advice on the legal feasibility of policy options	Can provide advice on the technical feasibility of policy options					
Appraising the options - Industry restructuring	Will lead on providing advice on complementary decisions of industry and market structure and the regulatory framework (see below)		Will provide advice on legal implications associated with restructuring	Will input into the decision if industry restructuring requires division of assets and other technical issues					

Key




-  Lead advisor
-  Significant involvement
-  Minor or optional involvement

Table 3-3 (continued)
 Role of advisors in stage 1 – establishing the policy

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Appraising the options - Assessing the implications on transitional objectives	Cost—benefit analysis usually undertaken by economists					May be required to provide an environmental impact assessment	May be required to provide an assessment of the pension/ insurance costs of different options	Will provide advice on the employment implications of different options	
Appraising the options - Role of competition, regulation and contract	Will have responsibility for outlining where competition is effective and where regulation or contracts are necessary	Will advise on financial feasibility, impact on investor confidence and impact on sales revenue	Will assist with analysis of legal feasibility	Will assist with analysis of technical feasibility					
Appraising the options - Gauging stakeholder support	May have responsibility for presenting the analysis of the options and reasons for the selected path	May have responsibility for organizing and conducting investor roadshows			May contribute to the task of organizing and conducting investor roadshows				
Choose preferred option	Will advise on the detailed implications of various types of PPI	May model the ability of government to finance capital expenditure requirements given tariff assumptions	Will assist in advising on the form of PPI in the presence of legal constraints	May perform analysis of investment needs to see if government is able to afford capital expenditure requirements					The procurement strategist will advise on the choice of PPI given a procurement strategy

3.4.1 Role of economic advisors in policy formulation

3.4.1.1 Scoping objectives

Economic advisors can play a valuable role in providing advice on the range of objectives that might be achieved under different forms of PPI and the trade-offs among objectives.



The main output of this task is analysis of potential objectives that can be achieved under the different objectives.

3.4.1.2 Identify options

Economic advisors can establish the range of forms of PPI that can feasibly be considered, alongside options for consumer protection and industry restructuring.

3.4.1.3 Option appraisal

Economic input will be required to take forward specific elements of the appraisal of options. Economic advisors are likely to lead on the issues relating to the need for industry restructuring. They will also lead with the assessment of costs and benefits of reform, and they will have important inputs into the assessment of the existing legal and regulatory framework.

3.4.1.4 Choose preferred option

Economic consultants have the main input into the choice of PPI and related decisions. They will advise on the detailed implications of the different types of PPI outlined in Module 2. They will be able to assess the suitability of the various types of PPI, taking into account the specific circumstances of the country and sector concerned.



The main output will be a report on the appropriate form of industry restructuring and recommended form of PPI.

3.4.2 Role of financial advisors in policy formulation

3.4.2.1 Identifying options

Financial advisors, together with economic advisors, can help to establish the feasibility of specific forms of PPI, as well as different options for consumer protection and industry restructuring.

3.4.2.2 Option appraisal

The appraisal of options involves identifying a pipeline of appropriate projects for PPI. This may involve conducting preliminary investor surveys to identify whether there is sufficient interest from the private sector in specific projects. Its results may inform the design of the PPI program. Financial advisors may be best placed to conduct the survey because they are knowledgeable about potential investors¹⁴. To be useful, the survey should inform:

- the advisory team about the appropriateness of different PPI approaches and transaction strategies;

¹⁴ This should be balanced against the cost of using the financial advisors for this work. It may be that it is more cost effective to use the economic consultant or even a more specialist polling, market research or other firm to undertake the actual survey.

- the potential bidders about the approach to pre-qualification; and
- government officials of the information required by the bidders and bidders' concerns, which can be addressed either in the information memorandum or the request for proposals, or through pre-bid meetings.

Preliminary financial analysis and modeling of the financial feasibility of different PPI projects is likely to support the investor survey.

R The main output will be a report that identifies the degree of investor support for specific projects.

Stage 1 – Legal advisors

3.4.3 Role of legal advisors in policy formulation

3.4.3.1 Option appraisal

The legal advisor, together with the other advisors, should be involved in identifying and appraising the PPI policy options. The main input of the legal advisor will be in analyzing the existing legal and regulatory regime. The legal advisor will be required to:

- review the current legal and regulatory framework;
- identify any legal or regulatory constraints in the implementation of any of the policy options;
- suggest the range of changes required to the current legal and regulatory framework under different policy options; and
- indicate the extent of any legislative amendments that might be required and the likely time scales required to undertake them.

A The legal advisor will analyze the current legislative framework and identify the changes required under different options.

Stage 1 – Technical advisors

3.4.4 Role of technical advisors in policy formulation

3.4.4.1 Scoping objectives

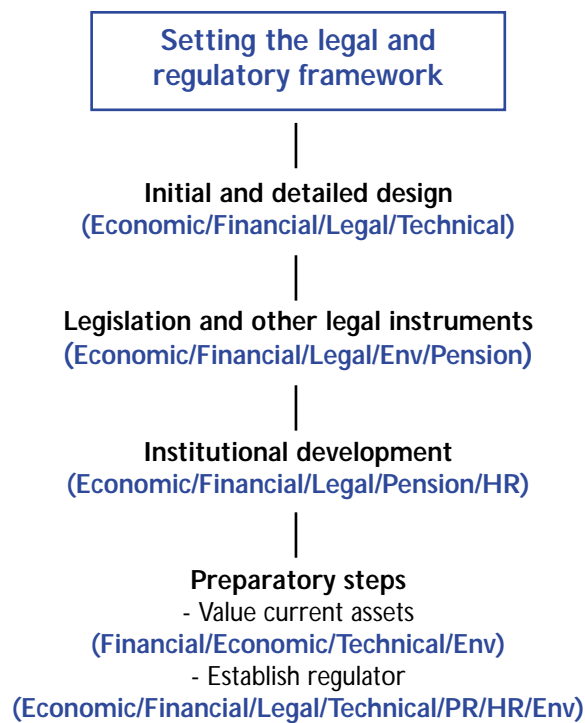
Where increasing capital expenditure is an objective of PPI, technical advisors will be required to provide information on the existing infrastructure and long-term investment needs where these have an impact on the objectives for PPI.

R The technical advisor will produce a report outlining the feasibility of different forms of PPI in delivering the government's investment-related objectives.

3.5 The role of advisors in stage 2 – establishing the legal and regulatory framework

Figure 3-4

Advisors used in stage 2 - establishing the legal and regulatory framework





A	Analysis or advice (often provided as a presentation)
R	Report
M	Model (technical or financial)
D	Draft documentation
T	Training
	Icons with multiple borders (e.g., ) indicate outputs produced by advisors that are submitted directly to government officials ; those with single borders, (e.g., A), indicate outputs produced by advisors that form an input to the work of other advisors .

Table 3-4

Role of advisors in stage 2 – establishing the legal and regulatory framework

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Initial and detailed design	Will analyze optimal risk allocation and impact on design.	Will advise on financial feasibility, impact on investor confidence. Together with legal advisors, will consider security arrangements	Will increasingly assume lead role as analysis moves from conceptual stage to preparation of legal instruments	Will have a major role in technical feasibility. Will assist with non-financial measures of assessing performance					
Legislation and other legal instruments	Will be required to provide legal advisors with outlines of legislation/regulations related to industry and market structure and regulatory framework	May advise on the impact of legislative change on sector's attractiveness to local and international investors	Will lead in drafting all documentation required to create or amend legal framework			May be required to assess the environmental impact of regulations	Will be required to advise legal team on how to draft regulations/legislation relating to the transfer of employee pension funds and other benefits		

Key




-  Lead advisor
-  Significant involvement
-  Minor or optional involvement

Table 3-4 (continued)

Role of advisors in stage 2 – establishing the legal and regulatory framework

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Institutional development	Will have lead advisory role on particular institutions for regulation or market development with respect to their location and structure	Will advise on financial structure of new institutions	Will prepare company statutes and other legal documents	Will advise on interaction with industry			Will be required to advise legal team on how to draft regulations/legislation relating to the transfer of employee pension funds and other benefits	Will play role in preparing and implementing program for institutional development	
Preparatory steps -Value assets	Will have an input on the choice of methodology May also be required to undertake valuation May be required to estimate optimal level of investment	May be required to undertake valuation. Will advise on the attractiveness of assets to private sector May be required to undertake financial modeling to support work of economists in determining optimal level of investment		Will have a key role in inspecting assets for purposes of valuation May be required to provide an estimate of need for future investment, including assessment of need to replace assets		May have a role in assessing cost of decommissioning assets May have a role in estimating environmental consequences of new investment			

Table 3-4 (continued)

Role of advisors in stage 2 – establishing the legal and regulatory framework

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Preparatory steps - Establish regulator	Will be required to undertake training of new staff in the requisite economic skills	Will be required to undertake training of new staff in the requisite financial skills	Will be responsible for ensuring any new legal and regulatory structures are properly implemented and that staff understand new laws	May be required to support regulator in initial stages, including provision of advice on types, roles and training of technical staff	May be used to ensure that wider community understands regulator's role	May be used to distinguish between regulatory responsibilities of economic regulator and environmental agency		May provide advice on staffing and structuring of regulator's office, hiring of staff, and defining internal procedures	
Preparatory steps - Design tariff	May be involved in calculating tariff and advising on tariff structures. Economists may also be required to advise on pros and cons of different tariff-setting methodologies	Input on the cost of capital may be required. May advise on impact of different approaches to setting tariffs on investors' perceptions of risk		Will be required to advise on whether tariff level will allow companies to meet obligations in terms of standards of service					

3.5.1 Role of economic advisors in establishing the legal and regulatory framework

3.5.1.1 Initial and detailed design

Economists will play a prominent role in the initial design of competitive markets, regulatory solutions, and contract structures. As the work proceeds to detailed design and preparation of legal instruments, the role of the economists will decline and the role of other advisors – in particular legal advisors – will increase. At these stages the role of economic advisors is to ensure that the laws being drafted are consistent with the current and anticipated industry, market and regulatory framework.

The balance between advisors will depend on their individual skills and experience. Generally, it is a mistake to move towards legal drafting before the outline is clear, and the input of advisory skills should reflect the need for continued support from economic advisors. Since legal companies are generally more expensive than economic consultancies, regulatory design work involving both types of skills is often led by economic consultants, who then subcontract lawyers.

3.5.1.2 Legislation and other legal instruments

Where a regulatory approach is adopted, economic advisors play an important role in advising on the appropriate regulatory framework, given the form of PPI and the government's objectives. While the legal advisors may take the overall lead in this task, economic advisors are likely to lead in advising on the system for economic industry regulation. They may also assist in drafting parts of the legislation that require an economic input.

Along with the form of PPI and associated decisions (e.g., structure of the industry, type of regulation), the draft regulations will form the core of the reformed sector. The draft regulations outline instructions from the government to the regulator or contract monitor. Economic advisors must first consider the degree of detail to be included in these regulations or the concession contract (e.g. whether the government should specify the form of tariff setting methodology or only the objectives of tariff-setting). Once this is decided, they provide advice to the legal advisors on the content of the regulations or concession contract being drafted. They should identify the implications of including specific details in the legislation, from relatively well-known issues (e.g., implications of price and revenue caps versus cost-plus tariff-setting) to more detailed issues (e.g., the formula for the recovery of stranded costs).

A **The economic advisor will provide recommendations to the legal advisor on the regulatory framework and advice on the content of the regulations or contract.**

3.5.1.3 Institutional development

The role of advisors will depend on the solution adopted. Competitive markets in infrastructure (e.g., electricity pools) are relatively recent innovations. Economists and technical specialists will play a leading role in their design and in the development of the accompanying institutions.

Where a regulatory approach is adopted, the main role for economic consultants in establishing the regulatory office will be in training new personnel in the requisite economic skills. While many regulators will have economists as members of staff, few are likely to have staff with experience of economic regulation of the infrastructure sector in question. Although the level of economic training required will depend on the backgrounds of the new personnel, usually some transfer of skills is necessary.

There is more global experience in the management of contracts. Legal advisors can play a major role in advising on the requirements for contract management, and in providing assistance with institutional development.



The economic advisor will train government officials in economic regulation.

3.5.1.4 Preparatory steps

The preparatory steps will also be dependent on the solution adopted. Where a regulatory regime is being established, work will be required on the overall approach to regulation, the preparation of guidelines explaining how regulation will work, and the initial steps (e.g., determining allowable revenues consistent with the form of regulation). Economic advisors will require support with the identification and valuation of assets, and from technical specialists and financial advisors with the preparation of financial models.

Value assets

If one of the tasks is to be valuation of the assets, the economic advisors will help determine the appropriate methodology. While most economic, financial and technical consultants are likely to be able to carry out the formal financial modeling required to derive an asset value, they first need to choose the appropriate methodology. The choice of methodology will affect not only the privatization process but also the incentives for the new private participants geared towards future investment, the requirements on the regulator and the cost of supply to final consumers.

If the government decides to assess future investment needs, economic advisors might have a role in advising on the level of investment the private sector should undertake.

Propose tariff-setting methodology

If the economic advisors have not set out the tariff-setting methodology in the legislation or concession, they will often have a role in outlining the advantages and disadvantages of various approaches to the regulatory body or government/public sector sponsor. The work of the economic advisors should extend beyond the broad overview of the various methods (e.g., price, revenue caps) to outlining, in detail, both how each methodology should be applied in the country under consideration and the implications of the various possible nuances under each broad methodology (e.g., different possible error correction mechanisms under revenue caps).



The advisors produce a report outlining alternative methodologies and a recommended approach.

Tariff design

After advising on the methodology to regulate average tariff revenues, the economic advisors may be involved in calculating the tariffs, advising on tariff structures, and participating in the first tariff review. They may also advise on the design of cross-subsidies from one type of user to another (e.g., industrial or domestic in power and water or containers and dry bulk at ports and railways), where there is a need to ensure universal service obligations. It is important to ensure that foreign advisors' skills on tariff design and setting are transferred to local staff.



The economic advisor will provide the government with recommendations on tariff design.

3.5.2 Role of financial advisors in establishing legal and regulatory frameworks

3.5.2.1 Initial and detailed design

The main role of the financial advisor will be to advise on the impact on investor confidence and on sale revenues. Depending on the solution adopted, there may also be substantial need for financial modeling. Financial advisors may also provide advice on cash flow and capital and operating expenditure projections under different legal and regulatory frameworks.

3.5.2.2 Legislation and other legal instruments

The financial advisors may have a small input into the drafting of regulations or regulatory sections of a concession contract. This input will include advice on the impact of the regulations and on the attractiveness of the sector to local and international investors. In particular, financial advisors can assess the impact of the regulatory system on investors' perceptions of risk.¹⁵

3.5.2.3 Institutional development

In all cases where institutions are to be financially self-supporting, financial advisors will need to advise on financial structure and the revenues the institutions will require. They will also need to identify and analyze the impacts of funding from different sources, e.g., annual payments made to the institutions by the private sector operators, or levies on customers.

Regulatory solutions are likely to require the development of financial modeling tools, in order to determine the viability of companies under different assumptions. Such financial modeling tools will need to incorporate the following information:

- revenue;
- expenses;
- staff numbers;
- tariffs; and
- accounts.

Figure 3-4 provides an example of such a model.



The financial advisor will build a model showing the impact of different regulatory decisions on financial indicators.

¹⁵ It should be noted that if the financial advisors claim that a certain regulation will decrease investor interest or increase their risk this does not necessarily mean that the regulation should not be implemented. In general, any regulation removing some profit from investors will decrease their interest (while benefiting consumers). This is just another factor that should be taken into account.

3.5.2.4 Preparatory steps

Value assets

The financial advisors may have two roles in the valuation of assets. The economic, financial and technical experts are all likely to possess the skills to undertake the necessary modeling once the economic advisors and the government have decided on the methodology. In addition, the financial advisors are likely to have a better understanding than either of the other two groups about the attractiveness of saleable assets. They will be able to assess the risk associated with the country and its impact on the introduction of PPI.



The financial advisor will value assets and provide analysis of asset valuations on investor confidence.

Figure 3-5
Example cash flow projections for a gas pipeline

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006..	2020
<i>Net Cash Inflows from Operations</i>											
Operating Surplus	386.91	105.63	548.86	4,717.89	8,981.92	11,398.53	10,176.29	4,153.51	4,161.67	6,532.44 ..	67,580.38
Interest and Dividends Receivable	-32.37	-46.59	-62.23	-0.48	-0.48	-0.48	-0.48	-149.55	-149.55	-224.09 ..	-298.63
Depreciation	102.51	350.67	393.70	210.18	283.51	347.94	418.82	491.96	499.93	508.70 ..	11,802.74
Taxation	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
Dividends Paid Out	-84.53	0.00	0.00	-2,674.69	-3,265.74	-4,824.57	-4,403.93	-1,393.07	-1,448.85	-1,517.23 ..	-26,860.38
(Profit)/Loss on Sale of Investments	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
(Profit)/Loss on Sale of Fixed Assets	0.00	0.00	0.00	560.47	-158.95	-124.05	-122.13	-142.62	-127.25	-125.01 ..	0.00
(Increase)/Decrease in Stores	-2.02	-16.68	-64.16	60.00	-67.66	-74.42	-76.79	-8.37	-9.21	-1,137.88 ..	-38.46
Decrease/(Increase) in Debtors	1.65	-125.93	-215.97	-1,206.53	-772.59	-540.60	40.66	-946.55	-325.68	-1,324.63 ..	-1,460.39
Increase/(Decrease) in Creditors	3.24	-42.94	110.21	838.91	269.74	192.70	224.93	2,931.58	484.12	1,421.57 ..	2,905.66
Net Cash Inflow from Operations	375.38	224.15	710.42	2,505.76	5,269.75	6,375.05	6,257.38	4,936.89	3,085.20	4,133.87 ..	53,630.93
<i>Return on Investments & Servicing of Finance</i>											
Interest and Dividends Received	1.90	46.59	62.23	0.48	0.48	0.48	0.48	149.55	149.55	224.09 ..	298.63
Interest Paid	-11.46	-182.06	-667.68	-1,339.44	-1,521.94	-1,284.29	-847.77	-796.01	-736.56	-3,012.00 ..	-7,770.66
Net Cash Outflows	-9.55	-135.47	-605.46	-1,338.96	-1,521.46	-1,283.81	-847.29	-646.45	-587.01	-2,787.91 ..	-7,472.04
<i>Investment Activities</i>											
Purchase of Fixed Assets	-20.89	-565.10	-1,833.15	-2,199.79	-1,933.08	-2,126.39	-2,194.10	-239.12	-263.03	-32,510.77 ..	-1,098.75
Purchase of Investments	-40.91	0.00	0.00	0.00	-1,475.64	-605.12	-646.25	-690.17	0.00	0.00 ..	0.00
Interest Capitalised	0.00	96.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
Exchange Rate Losses Capitalised	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
Receipts from:	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
- Sale of Fixed Assets	0.00	0.00	0.00	960.61	158.95	124.05	122.13	142.62	127.25	125.01 ..	0.00
- Realisation of Investments	0.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00 ..	0.00
Net Cash Outflows	-61.55	-468.69	-1,833.15	-1,239.17	-3,249.77	-2,607.46	-2,718.23	-786.67	-135.78	-32,385.76 ..	-1,098.75
Net Cash Outflow Before Financing Activities	304.27	-380.01	-1,728.19	-72.37	498.52	2,483.78	2,691.86	3,503.77	2,362.41	-31,039.80 ..	45,060.14

Design tariff

Financial advisors will have minimal input into the choice of tariff-setting methodology. This may include advising on the impact of different methodologies on attracting private sector investors, and on future private sector investment.

Financial and economic advisors should consult each other about specific aspects of tariff design. Financial advisors should have experience in similar markets elsewhere to inform estimates of the cost of capital for new investors.

T The financial advisors will provide this tariff analysis to the economic advisors.

3.5.3 Role of legal advisors in establishing the legal and regulatory framework

3.5.3.1 Initial and detailed design

The legal advisors will play a major role in determining the legal changes necessary to accommodate alternative approaches, and the impact of these on program timetables. The legal advisors should therefore participate in the processes of both initial and detailed design. The outline structure should be agreed before legal drafting. However, the respective roles of advisors will depend on their individual skills and experience.

Drawing on their analysis during stage 1, the range of tasks the legal advisors undertake includes:

- more extensive review of the current legal and regulatory framework, and identification of necessary changes to it, given the choice of form of PPI;
- due diligence on corporate and debt issues, labor-related issues, health and safety, litigation and environmental issues;
- preparation of draft transaction documents; and
- identification of the changes that need to be made through primary legislation, secondary legislation, licenses and other legal instruments.

A The legal advisors will provide this legal analysis to the economic advisors.

3.5.3.2 Legislation and other legal instruments

The design work will result in preparation of legislation. Depending on the particular circumstances legal advisors may draft the legislation or may provide an outline bill to be filled in by government draughtspersons familiar with specific local requirements.

Legal advisors will also prepare other legal instruments, including codes establishing the operations of a wholesale market, trackage rights agreements, licences establishing the obligations of the companies concerned, and specific contracts.

At an early stage this work will entail close liaison with the economic advisors. The legal advisor will have the principal role of drafting all documentation necessary to create or amend the legal and regulatory framework relating to the PPI project at an early stage. They will do this in conjunction with economic advisors because it will be a key concern of potential investors. Draft laws and regulations will need to be

circulated to, and discussed with, all interested stakeholders. The legal advisor will be responsible for revising draft documentation in light of the consultation process.

Legal advisors are also likely to have the greatest skills in mechanisms to protect the interests of a contracting party, through warranties, guarantees, liquidated damages and other mechanisms, but may need to liaise with financial advisors on these issues.

D **The legal advisor will draft the necessary legislation and legal instruments for the implementation of the PPI reform.**

3.5.3.3 Institutional development

In all cases where institutions are to be autonomous, legal advisors will prepare their statutes and company structure and ensure that they meet other requirements. There is also likely to be an ongoing need for legal advice to the new institutions.

3.5.3.4 Preparatory steps

During the preparation of guidelines, legal advisors will assist in determining the extent of powers under legislation, and the interpretation of disputed issues.

The legal advisor may be responsible for ensuring the proper implementation of any new legal or regulatory structures. However, the government will retain important responsibilities in this area as the only entity able to implement the new legislation.

A **Legal advisors provide advice to the government on the requirement for implementation.**

3.5.4 Role of technical advisors in establishing the legal and regulatory framework

3.5.4.1 Initial and detailed design

The technical specialists will play a role in both initial and detailed design. Depending on the solution adopted, specialists may need to advise on the ability to split assets both vertically and horizontally.

A **The technical advisor will provide input to economists on the technical aspects of market design.**

3.5.4.2 Institutional development

Technical specialists may play a major role in institutional development. Regulatory institutions will require a close understanding of how their sector operates and how technical performance can be measured.

3.5.4.3 Preparatory steps

Regulatory solutions are likely to involve identification and valuation of assets. Technical specialists will undertake the bulk of this work. Contracts that transfer responsibility for fixed assets may require similar steps.

Value assets

The technical experts will play a key role in the valuation of existing assets. The technical advisors will physically inspect all (or a representative sample) of the assets, assess their current state and, in consultation with the economic and financial advisors, estimate their value.¹⁶ However, the valuation needs to be grounded in economic and financial reality, the absence of which can give the government unrealistic expectations about the value of the assets. This can cause the privatization to fail, especially if the government sets minimum bids based upon inflated valuations.

Following their review of the design, technical status and condition of the assets, the technical advisors may provide an assessment of the need for future investment. This may include an estimate of the cost of restoring the assets to a reasonable, appropriate or working condition. It may also include evaluation of the extent to which existing assets or networks can be extended or replaced. In addition, technical advisors may conduct an initial environmental impact study or review any existing current study with a view to assessing the need for future investment. Finally, the advisor may need to design Information Technology (IT) requirements or review any IT systems included in the design of the project.

Where a regulatory approach is adopted, the technical advisors will support the regulator in its initial stages. This role may involve simply advising the government on the qualifications and choice of any required technical staff or may be a more detailed involvement with the regulatory office, including the transfer of specific technical skills.



The technical advisor will provide input to the financial advisor on asset valuations and will train the regulatory staff on technical aspects of regulation.

Design tariff

The technical advisors' inputs to the tariff design focus mainly on setting and ensuring that the final tariff level provides sufficient revenue for companies to meet the service standards required in order to ensure the proper safety and operation of the system. They will also be responsible for providing information on monitoring capital expenditure to the economic and financial advisors designing the tariffs.



Technical advisors provide this input to economists.

Stage 2 – Human Resource advisors

3.5.5 Role of human resource advisors in establishing the legal and regulatory framework

3.5.5.1 Institutional development

One of the main roles for human resource advisors is in setting up the institutions required to operate new markets, implement regulation and manage contracts. Working with the economic and technical advisors, they will design the appropriate staffing structure, define job requirements, advertise for and hire new applicants, and

¹⁶ It is important to note that in the case of an asset sale ultimately the value of the assets will be determined by the winning bidder. However, bidders are likely to want at least an initial assessment of the assets from the technical advisors, and then they may choose to send in their own specialists for a more detailed examination.

ensure the smooth transition to the new office. Once the office has been set up, they should be able to identify the training and other needs of staff and set up appropriate training courses, which will probably be provided by the economic, financial and technical advisors.

R The HR advisors will prepare a report with their recommendations for staffing of any new institutions.

Environmental advisors – Stage 2

3.5.6 Role of environmental advisors in establishing the legal and regulatory framework

3.5.6.1 Legislation and other legal instruments

Environmental advisors will identify the specific environmental standards to be incorporated into new legislation or regulations. These standards should reflect both the benefits of a cleaner environment and the costs of remedying and/or avoiding environmental degradation, and should be in line with current and anticipated best practice and international obligations.

The environmental advisor will provide analysis of the environmental implications of proposed legislation and other legal instruments.

Pensions advisors – Stage 2

3.5.7 Role of pension/insurance specialists in establishing the legal and regulatory framework

3.5.7.1 Institutional development

The draft regulations that govern the sector once PPI has been introduced must, where appropriate, address issues such as the transfer of staff to the new entities, the transfer of pension funds and the treatment of other benefits.

A Pension/insurance specialists provide this input to the legal and economic advisors.

3.6 Role of advisors in stage 3 – tendering the contract

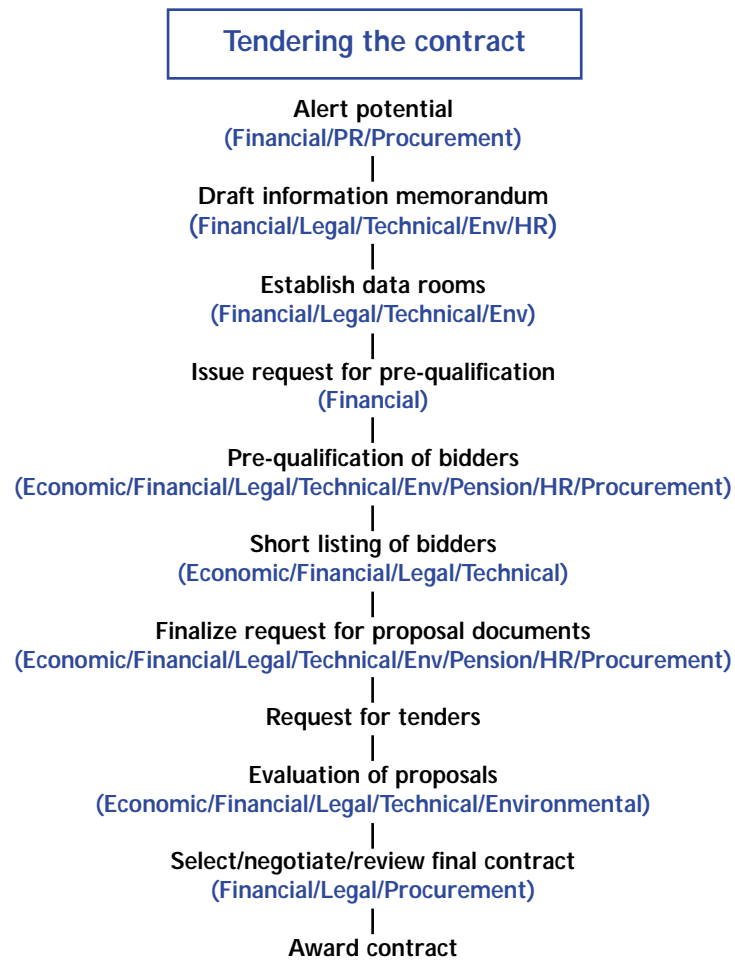


Table 3-5
Role of advisors in stage 3 – tendering the contract

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Alert potential bidders		Financial advisors will play a key role in publicizing potential investment opportunity to investors			May be required to co-ordinate and input into publicizing potential investment opportunity to investors				Advise throughout stage 3 on best approach to meeting objectives, how to present information and conduct bid
Draft information memorandum		Will draw up memorandum and will advise on its dissemination	Main input will be to draft legal and compliance sections	Will be required to provide sufficient technical detail to allow potential investors to determine whether they are interested in the project		Will provide further details on extra costs of environmental obligations that will be borne by the winning bidder	Will need to provide information on existence of pension funds and other benefits that will become responsibility of successful bidder	Will be required to provide information on the size and qualifications of existing workforce	

Key




-  Lead advisor
-  Significant involvement
-  Minor or optional involvement

Table 3-5 (continued)

Role of advisors in stage 3 – tendering the contract

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Establish data room		Financial advisor will oversee assembly of material and will coordinate with other advisors on its input	Will have responsibility for organizing limited access to data room and any required confidentiality agreements	Will advise on technical documentation placed in data room so potential investors can determine their interest in the project		May be required to specify documents to be placed in data room			
Issue request for pre-qualification		Will advise on how best to market opportunity to potential private sector investors							
Shortlisting	Will have knowledge of companies from other countries and will be able to advise on economic content of pre-qualification submissions provided for purposes of shortlisting	Will review the pre-qualification submissions. May be required to review financial standing of bidders to ascertain their ability to participate in the project	Will need to advise on information to be provided in any notice inviting enquiries	Input will be central in deciding criteria against which potential bidders are judged and in the evaluation process					

Table 3-5 (continued)


Role of advisors in stage 3 – tendering the contract

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Prepare final request for bid proposals	Will write or review the economic sections of request for bid proposals	Will brief bidders, prepare preliminary financial models and examining effect of the financial requirements on ability of project company to service debt	Will prepare outline or draft contracts sent to pre-qualified bidder	Will prepare all technical sections, schedules and drawings to be included in bid documents		Should outline further details on extra costs of environmental obligations that will be borne by winning bidder	Should provide information on existence of pension funds and other benefits that will become responsibility of successful bidder	Will provide information on staffing levels and payments	May need to check request for proposals to see that it is consistent with procurement strategy
Evaluate bids	Will review economic sections of the bids	Will be required to assess financial viability of bids	Will undertake analysis of any proposed amendments to draft agreements contained in bidding documentation	Will have substantial input into evaluation process		Will ensure that bids meet required standards set out in request for proposals			
Negotiate final contract		Will be required to assist in the negotiation and finalization of a range of issues	Will assist in negotiations to secure agreement on the PPI arrangement. Will draft PPI agreements and documents as commercial negotiations conclude						May be involved in final contract negotiation

3.6.1 Role of economic advisors in tendering the contract


3.6.1.1 Shortlisting

Given the central role played by economic advisors in the reform process, they should have an input, along with the other advisors, in the shortlisting of the companies. Typically, they have knowledge and experience of the companies from other countries or regions. If the shortlisting is based on a form of technical proposal, the economic advisors may evaluate the economic content of the proposal.

 **The economic advisors will provide input on the economic aspects of shortlisting.**

3.6.1.2 Prepare final request for proposals.


The economic advisors will typically have a relatively small role in the preparation of the final request for proposals. Their input will be either in writing the economic sections or in reviewing the request for proposals to ensure consistency with the regulatory framework or concession contract and the choice of PPI.

 **The economic advisors will draft the economic sections of the request for proposals.**




 Analysis or advice (often provided as a presentation)

 Report

 Model (technical or financial)

 Draft documentation

 Training

 Icons with multiple borders (e.g., ) indicate outputs produced by advisors that are submitted **directly to government officials**; those with single borders, (e.g., ) , indicate outputs produced by advisors that form an **input to the work of other advisors**.

3.6.1.3 Evaluate proposals

The role of economic advisors in the evaluation of proposals will possibly be limited to the economic sections. At a more detailed level, if bidders are suggesting alternative approaches to the same project (e.g., one demanding more guarantees than another), the economic advisors, along with their financial counterparts, should be able to evaluate the risks of the different proposals from the government's perspective.

- A** Throughout the third stage of the PPI process, the economic advisor will be required to provide advice on the economic content of proposed tender documents and bids.

3.6.2 Role of financial advisors in tendering the contract

3.6.2.1 Alert potential bidders

Financial advisors, possibly along with public relations specialists, will play a key role in publicizing the potential investment opportunity to investors. This will be a particularly important role in countries where capital markets are weak.

3.6.2.2 Draft information memorandum

The information memorandum will set out what the government is hoping to achieve, the scope of the proposed project, indicative financial and operational performance data, a description of the market structure, regulatory arrangements, the government's plans for implementation, and the deliverables it expects from the private sector investor. As one of the main parties supporting the government in its interaction with potential private sector partners, the financial advisors are best placed to advise on how to draw up the memorandum, and on its content and dissemination. However, they will need to ask for inputs from the other advisors for some of the content.

- D** The financial advisor will draft the information memorandum or provide advice to officials on how to do it.

3.6.2.3 Issue request for pre-qualification

The financial advisors will assist the government in defining how best to market the opportunity to potential private sector partners. This will involve conducting market soundings, drafting the advertisement to conform with relevant national and international procurement rules and, if necessary, raising awareness through relevant industry publications. The financial advisor should have extensive contacts within the investor community and should therefore be well placed to assess market demand both for the project itself and for variations of the same project (e.g., asset sale versus concession). This process may involve explaining the opportunity to potential private sector bidders.

Public relations consultants are also well placed to undertake some of these activities (see Section 3.6.5). Which advisors undertake the task will depend on their relative skills and costs, and the packaging of the Terms of Reference for advisors.

3.6.2.4 Shortlisting

The financial advisor, along with government officials, will review pre-qualification submissions. The information required and the process that determines the shortlist depends heavily on the weights attached to financial and technical criteria. However, this may involve detailed evaluation of the financial standing – perhaps using published financial reports and other available background information – of companies forming bidding groups to ascertain their financial ability to participate successfully in the project. The financial advisor may consider key financial indicators, such as turnover, profit, net worth, cash flows, gearing levels, and contingent liabilities, in deciding which bidders to select for the shortlist. In addition, advisors may evaluate other relevant background information, such as the bidder's track record of involvement in similar projects and its general technical expertise.



The financial advisor will provide advice on the pre-qualification criteria.

3.6.2.5 Establish data rooms

Data rooms contain commercially confidential information relevant to the bid that cannot be released to the public as a whole (see Module 2). Clear, informative data rooms are an important ingredient in attracting new investors. Lack of accurate data is often a difficulty in developing countries. Consequently, collecting and collating the data should begin once the form of PPI has been decided so that it is ready at this stage. The financial advisors should oversee the assembly of the material and co-ordinate with the other advisors on the content of the data room.



The financial advisor will oversee the assembly of material for the data room.

3.6.2.6 Prepare final request for bid proposals

The financial advisor will prepare the financial sections of the request for proposals. The financial advisor will ensure that the bidders, in meeting the financial requirements set out in the documentation, demonstrate the strength of the project company's ability to service the debt in the event of the occurrence of unforeseen events e.g. construction delays, cost overruns, delay in start of operations.

The financial advisor, in consultation with the government, the other advisors and any donors that are involved, will establish an evaluation procedure and develop criteria to evaluate and rank the bids.

3.6.2.7 Evaluate bids

A cross-section of government officials, financial, legal, economic and technical advisors and, occasionally, any donor agencies involved should undertake the evaluation of the proposals. All parties should have a clear understanding of the evaluation criteria and marking scheme, which will have been developed prior to issuing the request for proposals. One of these parties should be responsible for the overall coordination of the marking, usually the government or the financial advisor.

The financial advisors may assess whether bidders are internally consistent and bids are based on reasonable assumptions. They may also make checks on the quality of the service provider's proposed management team and the proposed arrangements for managing the project.

The financial advisor, in consultation with the government, the other advisors and any donors that are involved, will establish an evaluation procedure and develop criteria to evaluate and rank the bids. They may also provide assistance in briefing bidders and conducting clarification meetings.



Financial advisors will assist in the evaluation of bids.

3.6.2.8 Negotiate final contract

During this stage, the financial advisor will be involved in the detailed evaluation of the proposed contract and will advise the government during negotiations. The negotiations will often involve detailed considerations of the proposed contract; even minor changes may have a substantial impact over the length of the contract. Therefore, the financial advisors should be fully involved in advising the government as issues are raised and changes proposed. The financial advisor will also assist in the negotiation and finalization of issues such as:

- direct agreements with banks;
- insurance;
- termination compensation;
- staff transfer issues and pension rights;
- swap pricing;
- indexation factors;
- parent company guarantees;
- payment mechanisms; and
- any performance-related schemes.

They may co-ordinate with other specialist advisors, particularly legal advisors, in some of these areas.



The financial advisor will provide advice on the financial aspects of bidders' proposals to the government during negotiations.

3.6.3 Role of legal advisors in tendering the contract

3.6.3.1 Information memorandum

The legal advisor will need to be involved, in conjunction with the economic, financial and technical advisors, in the drafting of the information memorandum. The main input of the legal advisor will be the legal and compliance sections of the memorandum. The information memorandum will summarize the legal environment against which the PPI project will be undertaken. The legal advisor will prepare it.



The legal advisor will draft the legal components of the information memorandum

3.6.3.2 Shortlisting

The legal advisor will need to be involved, in conjunction with the financial and technical advisors, in agreeing to the mechanics of the pre-qualification process.

The legal advisor will need to advise on the information to be provided in any notice inviting enquiries. The legal advisor, together with the economic, financial and technical advisors, will be involved in the setting up and management of the data room. Shortlisted bidders will have a legitimate interest in specific project information, as well as in requesting clarification and discussions on the contract documentation. This will involve the compilation of a database of relevant information covering potential investors, potential contractors and background information relevant to the program. The legal advisor will assist in this process. Decisions will need to be made on the extent to which bidders can photocopy or otherwise reproduce data for their own use. Legal advisors will also be responsible for organizing limited access to the data room.

Finally, legal advisors may be responsible for drafting and monitoring the confidentiality agreements signed by companies with access to the data room.

A **The legal advisor will have responsibility for organizing access to the data room.**

3.6.3.3 Preparation of request for bid proposals

The legal advisor will need to prepare any outline or draft contracts to be sent to the pre-qualified bidders.

D **The legal advisor will prepare draft contracts.**

3.6.3.4 Evaluation of final bids

The legal advisor will have two main tasks in evaluating bids. The first is to determine that the bid is compliant in terms of the contract. This will involve a detailed comparison of the bid with the draft contract, on a clause-by-clause basis. This task will typically require a mix of skills – corporate, commercial and financial, as well as employment expertise.

The second is to review security arrangements and enforcement of the contract, and to establish whether the proposed terms and conditions protect the government against failure. Typically, legal advisors will work with financial advisors to determine the adequacy of security arrangements and the scale of risks to the government.

A **Legal advisors will ensure that all bids are compliant with the terms of submission.**

3.6.3.5 Negotiate final contract

Once a bidder has been selected, the legal advisor will play a major role in the negotiations to secure agreement on the PPI agreements and other documents. Usually it will be the government's role (or that of the relevant governmental agency, e.g., a central tender board) to contact the PPI parties. However the government may choose to delegate this role to the legal advisors (usually the consortium leader) to contact the PPI parties on its behalf. The PPI parties will usually be contacted by letter, which may be preceded by a telephone call.

The negotiations can be long and time-consuming and the legal advisor will prepare further drafts of all PPI agreements and documents as the commercial negotiations reach a conclusion. The legal advisor will have primary responsibility for ensuring that the final commercial agreement is properly reflected in the agreements and other documents.

3.6.4 Role of technical advisors in tendering the contract

3.6.4.1 Draft information memorandum

The information memorandum should contain sufficient technical detail to enable potential investors to determine whether or not they are interested in the project. The technical advisor should therefore co-ordinate closely with the financial advisor on the drafting of the memorandum. The technical component of the information memorandum will include the following:

- an asset registry;
- current operating and performance data;
- schematics/maps indicating the location of infrastructure and customers; and
- plans for capital improvement.

D **The input will be provided to the financial advisors.**

3.6.4.2 Shortlisting

In many projects, the technical qualifications of the companies will be the most important factor determining the shortlist. While the final selection may depend partly or wholly on the basis of price, shortlisting is often based on the technical qualifications of the companies. Consequently, the technical advisor should be central in deciding both the appropriate criteria and the subsequent evaluation in the formation of the final shortlist.

3.6.4.3 Establish data rooms

As with the information memorandum, it is vital that the data rooms contain enough information to inform interested investors. However, the data room should also contain all currently available information on the technical specifications of the system, including any preliminary analysis the advisors have undertaken on future investment needs.

3.6.4.4 Prepare final request for bid proposals

The technical advisor is responsible for the preparation of all the technical sections, schedules and drawings of the bid documents and also assists in the preparation of the necessary technical requirements. The technical advisor should also assist in preparing the technical evaluation criteria and the marking arrangements (see Module 6, *Volume II*).

D **The technical advisor will be responsible for preparing the technical sections of the request for bid proposals.**

3.6.4.5 Evaluate bids

The technical advisors are responsible for evaluating the technical sections of all bids received for the project, preparing a report, marking the technical sections of the bids, and ranking the bidders according to their technical responses to the bid

documents. This report will be submitted to the government or the financial advisor co-ordinating the marking.

D **The technical advisor will play an integral role in assisting with the bid evaluations.**

Stage 3 – Public Relations advisors

3.6.5 Role of PR advisors in tendering the contract

PR advisors will be involved in the PPI transaction and implementation stage, when the government is in a position to alert potential investors to a specific project. Failure to attract a sufficiently large pool of private sector investors capable of delivering the service to the appropriate standard will inevitably lead to problems later on. PR advisors will also promote the change in ownership to the public.

R **PR advisors will produce a report and presentations to attract private investors and ensure public support.**

3.6.6 Role of human resource advisors in tendering the contract

3.6.6.1 Draft information memorandum

The human resource advisors have an important input into the information memorandum. Often, one of the central issues in the introduction of PPI (particularly in the privatization of state-owned assets) is the size and qualifications of the existing workforce. The human resource advisors will outline the issues the new investor is likely to face if it assumes either ownership or management responsibilities.

3.6.6.2 Prepare final request for bid proposals

The final request for proposals should contain more detailed inputs from the human resource advisors under the same headings as those in the information memorandum. This should include an analysis of the current staffing arrangements and a preliminary assessment of future requirements.

A **This input will be provided to the financial advisors.**

Stage 3 – Environmental advisors

3.6.7 Role of environmental advisors in tendering the contract

3.6.7.1 Draft information memorandum

The environmental advisor should outline in detail in the information memorandum any specific investment related to the environment, or to mitigation of the environmental impacts of the project, that the bidder would need to undertake. In particular the information memoranda should reference specific legislation that the bidders would be expected to comply with, and should establish the minimum standards for pollution, environmental emissions and other impacts.

3.6.7.2 Prepare final request for bid proposals

Any further details on extra costs that will be borne by the winning bidder because of environmental concerns or mitigation requirements should be outlined in the final request for proposals.

3.6.7.3 Establish data room

Environmental advisors may be required to provide input on the documents to be placed in the data room.

3.6.7.4 Evaluate bids

Environmental advisors will review all bids received to ensure that they meet the minimum environmental standards contained in the request for proposals.



The environmental analysis will form part of the final government decision.

3.6.8 Role of procurement strategist in tendering the contract

A procurement strategist can assist in ensuring that the final request for proposals and the evaluation process are fair and transparent.



The advisor will advise the government on the appropriate approach to the procurement process.

3.7 Role of advisors in stage 4 – managing the PPI contract

Figure 3-7

Advisors used in stage 4 - managing the PPI contract



- A Analysis or advice (often provided as a presentation)
- R Report
- M Model (technical or financial)
- D Draft documentation
- T Training
- Icons with multiple borders (e.g.,) indicate outputs produced by advisors that are submitted **directly to government officials**; those with single borders, (e.g., A), indicate outputs produced by advisors that form an **input to the work of other advisors**.

Table 3-6

Role of advisors in stage 4 – managing the PPI contract




Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Establish team								Will be required to advise on required staffing levels and structure of new team	
Monitor contract	May be required to provide ongoing support either to government or regulatory body overseeing contracts and licenses		Will advise on such issues as compliance with the PPI project agreements, record any variation or amendment to the project agreements and assist in conflict resolution	Will assess whether private sector contractors have met required standards in relation to asset maintenance and investment					
Review performance indicators	Can advise on incentive effects of performance indicators								

Table 3-6 (continued)

Role of advisors in stage 4 – managing the PPI contract

Tasks	Economic advisors	Financial advisors	Legal advisors	Technical advisors	PR advisors	Environmental advisors	Pension/ insurance specialists	HR consultants	Procurement strategists
Evaluate reform	May be involved in evaluation of reform	May provide support on evaluation		May provide support on evaluation		May provide information on environmental impacts of reform			May be involved in evaluation
Renegotiate contract (if applicable)	May provide input on pricing and tariffs	May provide financial modeling	Will draft any amendments to contract and advise on implications of these	Will be responsible for establishing new contractual requirements relating to technical standards					May assist in contract evaluation

Key

-  Lead advisor
-  Significant involvement
-  Minor or optional involvement

3.7.1 Role of economic advisors in managing the contract

3.7.1.1 Review performance indicators

The task of monitoring the contract will mainly fall to the team established within the government to take the PPI program beyond the stage of contract award. However, economists can provide advice on the incentive effects of performance monitoring and possible distortions to behavior.

3.7.1.2 Evaluate reform

The task of monitoring the extent to which the PPI reform has been a success will fall to government officials or, where these exist, to an audit office or commission. However, depending on the scale of the reform, some of this work may be contracted out to economists. The range of issues addressed within the evaluation will reflect the original objectives of the PPI program and may include the extent to which the private sector provider maintained levels of service and quality standards or the success of the program in driving down tariffs.

R The economic advisor may provide a report evaluating the reform.

3.7.1.3 Contract renegotiation

Under limited circumstances the terms and conditions contained in the contract will need to change as a result of pre-specified changes of circumstances. This may require renegotiation of some elements of the contract (e.g., tariffs) before its expiry. Economic advisors may have a role in assessing whether renegotiation should take place and in supporting the government during the renegotiation if it proceeds.

A The economic advisors will provide support should there be any changes or challenges to the regulatory regime or contract.

3.7.2 Role of financial advisors in managing the contract

3.7.2.1 Contract re-negotiation

Financial advisors may be involved in aspects of contract re-negotiation. In particular, they will advise officials on financial modeling.

3.7.3 Role of legal advisor in contract management

3.7.3.1 Monitor contracts

The legal advisors will have a limited role in contract management. They may provide the government with advice on breaches of particular contractual terms.

3.7.3.2 Contract re-negotiation

Legal advisors will play a substantial role in any contract re-negotiation. They will be involved in the drafting of any amendments to the contract and will be able to advise the government on the implications of specific terms and conditions.



The legal advisor will be required to draft any contract amendments.

Stage 4 – Technical advisors

3.7.4 Role of technical advisors in contract management

3.7.4.1 Monitor contract

Technical advisors may be involved in evaluating the extent to which private sector providers meet the required asset maintenance, operational and investment standards.

3.7.4.2 Renegotiate contract

Technical advisors will be responsible for establishing new contractual requirements relating to technical standards.

Stage 4 – Human Resource advisors



3.7.5 Role of human resource advisors in contract management

3.7.5.1 Establish team

The introduction of PPI will require some reorganization of existing staff into newly created posts or units within the existing government or public sector institutional structures, in order to assist with performance monitoring or liason with the relevant regulatory institutions. Human resource advisors, perhaps in conjunction with the key advisors need to implement substantial training programs.

Consultancy terminology

To get the best out of advisors it is useful to be aware of the terminology they use. The following glossary sets out some of the terms consultants use in their day-to-day business.

Billable time – time spent on work that can be charged to the client.

Capability statement – document describing a consultancy's expertise and experience: also known as Statement of Qualifications.

Development – work undertaken by consultants in order to develop a company's capability.

Loss leader – unprofitable work undertaken in order to gain entry into a market.

Per diem – can mean daily fee rates but usually means the money required to cover daily meals, local travel and hotel expenses.

Productive days – the number of days per year that can be charged to a client.

Proposals – the documentation consultants provide to governments or project sponsors who wish to select advisors, often split into financial and technical components.

Request for proposals – the documentation sent to potential consultants or bidders. It comprises a letter of invitation, the terms of reference, and information about the format for proposals and the timetable and form of the evaluation process.

Terms of reference – detailed description of the tasks that consultants will be required to undertake, the range of deliverables, and the timetable.

Time and materials – payment based on the amount of time taken to undertake a task and the cost of any materials or other expenses incurred.

Travel and subsistence – part of the budget set aside to pay for the travel costs and living requirements of consultants involved in work undertaken outside of the consultants' offices; also referred to as out of pocket expenses.

Utilization rates – the proportion of a year spent on billable work. This is likely to be lower for more senior staff with responsibilities for marketing and bringing in new work.

Work in progress (WIP) – occurs when either the work has been undertaken but the consultant has not yet billed the client or where the work has not been undertaken but the consultant has received an up-front payment.

3.8 Local advisors

While there are compelling reasons to select advisors with international experience, local advisors will often have an important role to play in the PPI process

There are three main reasons for selecting local advisors:

- (1) They know and understand the country in question.
- (2) They serve as a conduit for transferring knowledge and building local capacity.
- (3) They may be more qualified than international consultants.

Advisors used for the first and second reasons are likely to undertake tasks that allow them to use their local knowledge, while learning from the international advisors about wider issues.

These tasks include those demanding specific knowledge of the country, such as:

- gauging and acquiring stakeholder support;
- analyzing, translating and explaining current laws and regulations;
- advising on the current regulatory environment;
- drafting new legislation and other legal instruments;
- valuing assets;
- liaising with the existing workforce; and
- ensuring smooth public relations.

For these tasks it may be useful to create teams of local and overseas consultants. The use of secondments provides an alternative way of establishing knowledge transfer. A team of both local and international advisors should ensure that consultants lacking experience of local conditions do not devise recommendations that are inappropriate for that country. It also provides a mechanism for allowing knowledge transfer – an important consideration if countries are not to become consultant-dependent.

Market forces will ultimately determine the appropriate level of remuneration of local advisors. Only local advisors used for the third reason—that they are the most qualified to undertake the work—are likely to command international fee rates (see Module 4). However, when this is the case, those fee rates should not be refused on the basis that the advisors happen to be local. In addition, the fee rates that local advisors will be able to charge may depend upon whether they are hired directly by the government, or whether they form part of the consortium of consultants that bid for the contract to provide advisory services. In the latter case, where there are few qualified local companies available to undertake their work, the local advisors may be able to negotiate high rates if they subcontract themselves to one of the many overseas consultancies putting together a team for the work (see discussion on forming consortia in Module 4).

Rather than employing consultants working in small local companies to contribute to tasks where local knowledge is required, it is worth bearing in mind that some of the larger consultancy and accountancy companies have offices in a large number of countries. These may offer an alternative route to local expertise.

Module 7 in *Volume III* discusses in more detail how to include local consultants in the evaluation of technical proposals.

3.9 Use of advisors by potential investors

Officials should be aware of how investors or bidders make use of advisors in the bidding process so the government can avoid potential conflicts of interest.

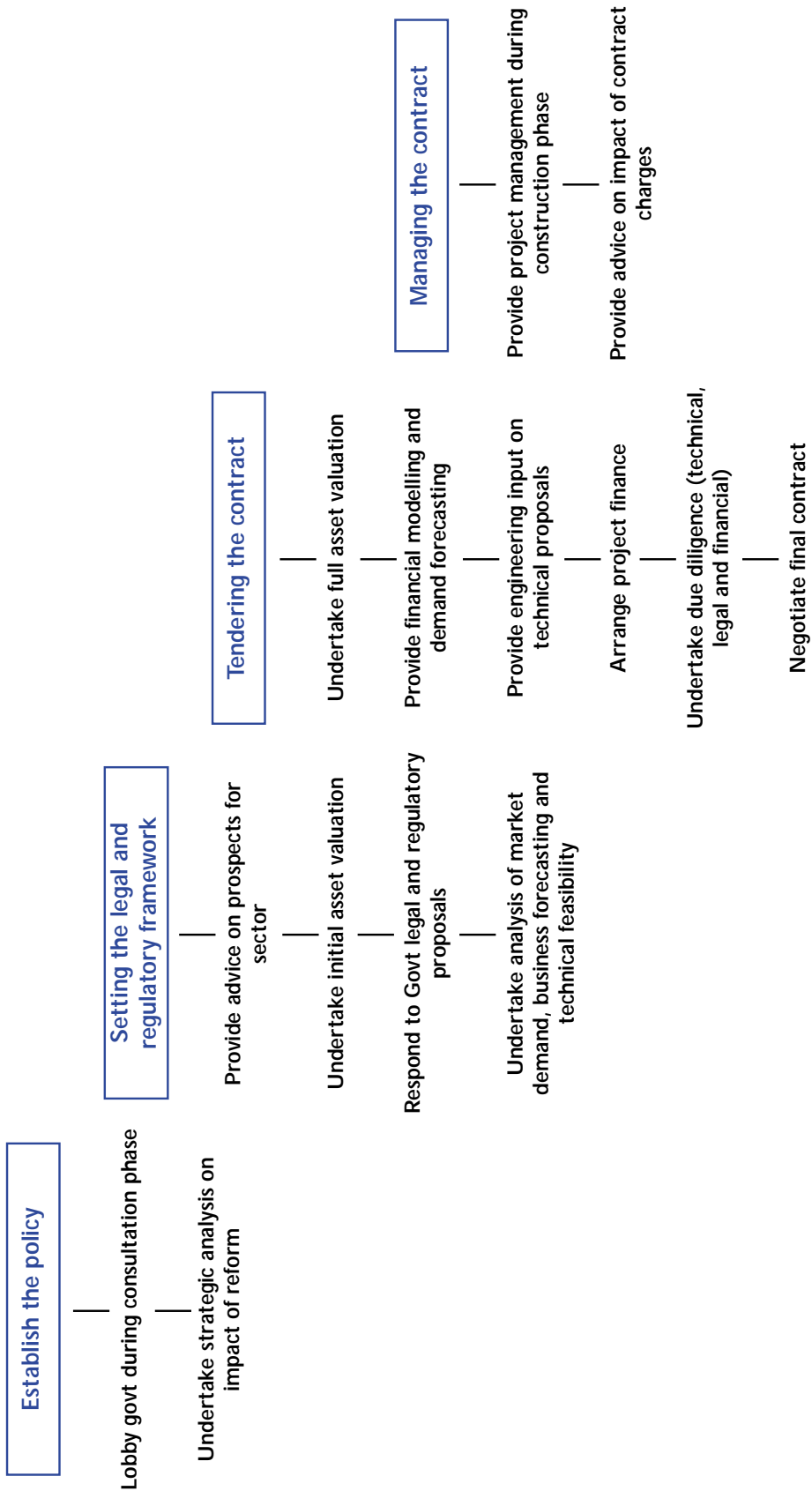
Private investors and bidders will be likely to use advisors if:

- they require lead advisors to manage a group of independent advisors;
- they do not have sufficient in-house expertise in specific areas; or
- they believe that, with the use of advisors, the overall cost for a specific project will be lower.

Investors' use of advisors largely mirrors governments' use because most of the tasks discussed have their private sector counterpart. The private sector consortia will use a similar set of advisors to the government, particularly when bidding for and implementing PPI projects. In fact, they may use the exact same advisors that the government has used in the past on similar projects or in other sectors. Given the choice, many consultants would prefer to work for investors since they generally pay higher rates. (See the discussion on conflicts of interest in Module 7 in *How to select and manage advisors, Volume III*).

The following figure illustrates the type of advice that advisors will provide to bidders at each stage of the PPI process.

Figure 3-8
Use of advisors by the private sector



3.9.1 Use of advisors during stage 1—formulating the policy

The use of advisors by the private sector during this stage is likely to be limited for the simple reason that the government will still be formulating its policy. Nevertheless the private sector may work with consultants:

- in responding to government consultation papers on the potential direction of government policy;
- when lobbying the government to encourage it to go down a particular route; and
- in devising a long-term strategy to enable them to respond quickly to any government reforms.

3.9.2 Use of advisors in stage 2—establishing the legal and regulatory framework

Again, the use of advisors will be limited because most of the tasks undertaken during stage 2 relate to information-gathering before the government issues the request for proposals. However, the private sector may use advisors once the request for proposals has been sent (and to a lesser extent once the government has received the expressions of interest) to undertake preliminary work including:

- background sector advice on the prospects for the sector;
- initial asset valuations so that potential bidders can decide whether they want to proceed; and
- response to government proposals about new regulations and legislation and tariff-setting.

3.9.3 Use of advisors in stage 3—tendering the PPI contract

It is during this stage that the use of advisors by the private sector is likely to be greatest. Most private sector consortia (excluding very large multinational companies) will use a financial advisor during the bidding and implementation stage. Similarly, unless members of the private sector consortium have experienced in-house lawyers, it will hire external legal advisors. Even if in-house expertise is available, consortia often use outside advisors to try to elicit a more impartial opinion than may be provided by in-house experts. In both cases these services will be utilized up to the point of financial close. The bidder may also require technical advisors, depending on its in-house capabilities. Private sector bidders might hire advisors for the following:

- due diligence, which involves assessing the legal and financial standing of the company, if the form of PPI is a sale of state assets or the bankability of a greenfield or concession project;
- to provide the financial structure, financial plan and financial and procurement strategy;
- to provide a cash flow program to identify tolls, tariffs or service charges for a greenfield or concession project;
- to conduct full-scale asset valuations;
- for the purposes of design (for example, IT systems and engineering input in the technical proposal);
- to carry out a technical due diligence of the project documentation and to establish capital and operating costs for a greenfield or concession project; and
- to carry out an assessment of any environmental impacts.

The project financiers, legal advisors and insurance advisors will also provide advice once the bidding consortium has been selected as the preferred bidder. The tasks advisors will undertake include:

- carrying out due diligence on all the technical and legal aspects of the project, prior to any commitment to lend to the project company. The legal advisors will continue to assist until financial close or bond issue;
- carrying out a technical due diligence of all technical aspects of the project itself and the specific bid; and
- negotiating the final contract, which will particularly involve financial and legal advisors, although economic and technical advisors will provide advice on the impact of any changes to the contract.

Once the contract has been awarded, or while the contract is being negotiated, the financial and legal advisors will assist the selected bidder in negotiating the financial documentation and all supporting contracts until financial close.

3.9.4 Use of advisors in stage 4 – managing the contract

Once the contract has been awarded, it is likely that the private sector will mostly rely on technical expertise during the construction and operation phase. In addition advisors might be brought in to:

- act as project managers during a construction and operation phase; or
- provide advice on any changes to the contract agreement – e.g., changes in price in response to pre-agreed changes in circumstances.

Finally, it is during this stage that economic advisors are used most. They will advise companies on a wide range of issues, depending on the form of PPI but including:

- price reviews and other regulatory proceedings;
- competition issues;
- pricing strategy vis-à-vis customers; and
- profit-maximizing strategies in more sophisticated markets.

Useful Reading

HM Treasury, *How to Appoint and Manage Advisors to Private Finance Initiatives*, Technical Note, 2000

Trivedi, P, *How to Implement Privatization Transactions: A Manual for Practitioners* World Bank and Harvard University Routledge, 2000

4. Defining the project and the contract

Outline of this Module

What this Module does:

This Module outlines the process for designing the scope of the proposed projects, as well as providing an indicative timetable for the entire PPI process. It also introduces key concepts for project design (e.g., conflict of interest, payment methods) that will be discussed in more detail in later Modules.

Who should read this Module:

Any official involved in defining the scope and budget of advisory services should read this Module. Those who need to understand the timeframe within which reforms and the introduction of PPI can occur should also read it. In general this will include the minister in charge both of the project and of allocating the budget (e.g., Minister of Transport and Minister of Finance in the case of a rail project) and the department specialists who will draw up the detailed terms of reference (e.g., procurement officer, head of privatization body, government team that will oversee the project).

4.1 Scoping consultancy projects

There are a number of issues that will need to be resolved before the process of hiring advisors can begin. These include:

- the appropriate phasing of advice—when should advisors be brought on board?
- grouping of tasks— what should advisors be asked to do?
- identifying the appropriate timetables— how long should advisors be given to complete their tasks?
- setting an indicative budget for the consultancy work— how much should advisors be paid?

Different levels and areas of government will be involved in each of these decisions. The project manager must therefore ensure that the decisions are consistent and that each party understands the impact of other decisions on the issues they are considering.

Table 4-1

Officials involved in scoping decisions

Decision	Government official likely to be involved
Phasing of advice	Project manager
Grouping or tasks	Project manager, senior civil servants in relevant ministries (e.g., Ministry of Telecoms if telecoms project)
Identifying timetables	Project manager, head of state*, ministers of relevant departments
Setting indicative budgets	Project manager, head of state*, Ministers of finance

* Depends on size of project. Smaller projects will not require such senior involvement. Senior civil servants can substitute but they should ensure that the minister or head of state agrees with the decisions being made.

Advisors should be phased in, recognizing their different skills

It is necessary to balance the costs of having advisors on board against the advantages of ensuring the availability of appropriate advice. As a general rule, advisors should be brought on board as early as possible. This will minimize the costs that arise when decisions are taken before all options, cost and benefits have been considered.

Module 3 provided a detailed discussion of the roles of different advisors. In balancing whether advisors should be present from the beginning or brought on board only for specialist activities, it is useful to distinguish between the tasks that different consultants perform.

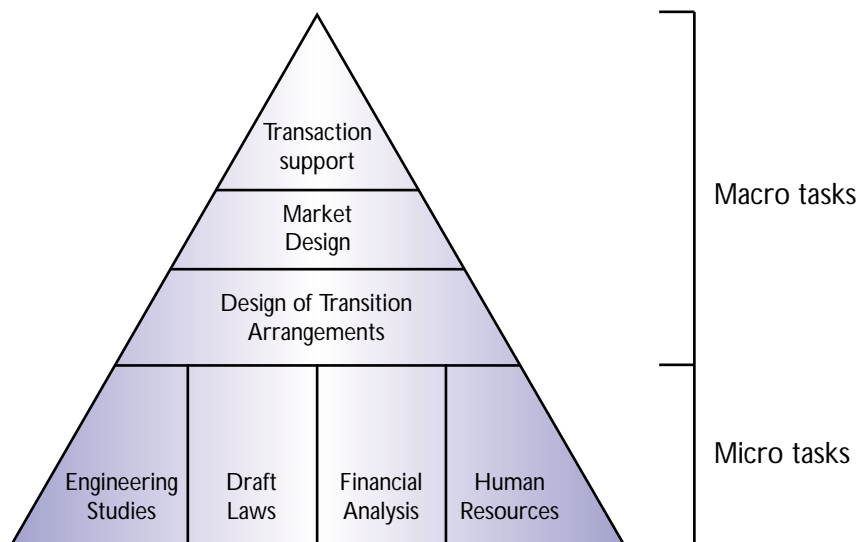
- Management, economic and technical consultants undertake higher level (macro) tasks (e.g., defining structures, transition arrangements, mechanisms, regulatory and other frameworks) and are more likely to be usefully involved from the beginning.
- Legal, human resource and financial consultants generally undertake lower level (micro) tasks, often under the direction of one of the consultants identified above. They may not be necessary from the beginning but it is important to have a clear idea about when they will be introduced (e.g., to draft legislation). Under some forms of PPI (e.g., greenfield projects, concessions) financial consultants may be needed from the outset to determine which options are feasible.

An advisor – probably the financial advisor – will advise on which arrangements are likely to be acceptable to the market. A strong focus on what form of transaction can realistically be completed is important from the outset.

While it is important to recognize that reform is an iterative process, and that advisors must all interact to ensure the final framework is consistent, each plays a different role. The roles described above are presented in Figure 4-1.

Figure 4-1

The advisory pyramid



Governments should specify the skills they need

Module 3 identified the different roles advisors play. In general it would be inappropriate to contract all advisory tasks to a single advisor. On the other hand, contracting each of the tasks identified in Module 2 as separate projects to different specialist advisors is also inappropriate. In practice, there needs to be a balance between the two extremes.

The precise grouping will depend on the skills that the shortlisted companies possess. In general, the requests for expressions of interest and for proposals should not specify the type of company required (e.g., investment bank, engineering company) but instead should indicate the range of skills that will be necessary to complete the job. Companies and individuals can then group themselves in order to ensure that the assignment can be completed to the timetable and required level of quality. The proposals should be judged on the range of skills and experience offered. This approach removes the government from the responsibility of grouping companies or prescribing the type of company, and also recognises that the companies are usually better placed to know where to find the required skills.

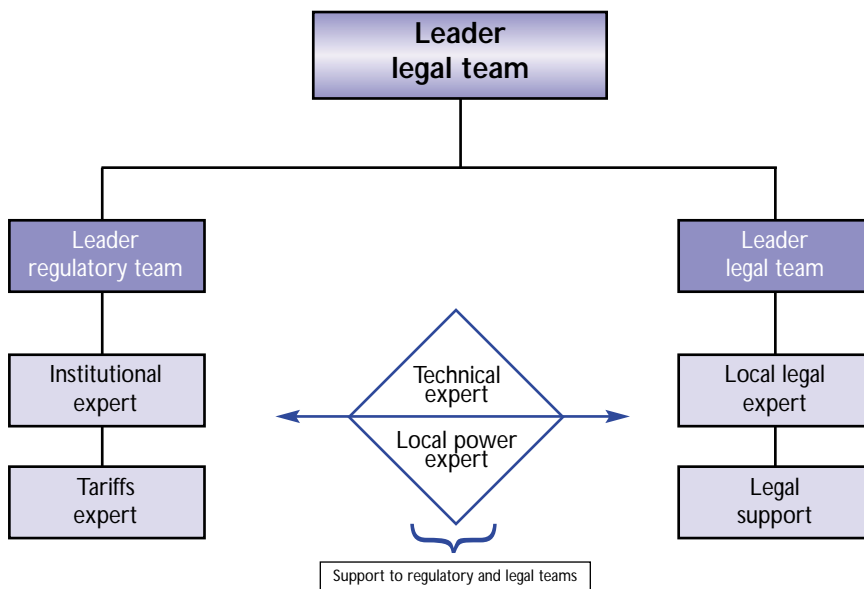
Figure 4-2 presents an example of a possible team structure based on one of the sample ToR from the Annex to Module 7, *Volume III*. Although there is no single correct way to present a team; in general the ToR will indicate:

- the skills required;
- the approximate team size;¹⁸ and
- a balance among senior and more junior members.

This information forms the basis both for the team membership and the structure.

Figure 4-2 Indicative team

(based on Acadia ToR, see Annex to Module 7, *Vol. III*)



¹⁸ Size may be indicated explicitly in the ToR by the positions that should be filled or by total time inputs (see example ToR in annex to Module 7).

Setting a realistic timetable

It is important to be realistic, in setting out the timetable, about which tasks advisors are to undertake. A consultancy project undertaken over too short a time runs the risk of generating inappropriate or wrong advice. Equally importantly, rushing to implement even correct advice can cause problems (e.g., stakeholders feel they have not been consulted or there is not sufficient time to explain the reforms in sufficient detail).

The timetable should be based on the tasks that the project will comprise and an estimate of the time required to undertake those tasks. Where the consultants need to arrange meetings and discussions with several individuals or organizations, the timetable ought to reflect this. Timetables often run into problems when they fail to recognize the time it will take to select advisors and consult with stakeholders. This creates a temptation to skip over consultation because it can be difficult to arrange meetings at short notice. However, the process of informing and listening to all stakeholders is central to the success of large PPI programs.

Figure 4-3 presents an indicative timetable of the minimum time needed to move from defining the objectives of the PPI process to execution. In practice, it is not possible to provide a general timetable. The timetable will vary from country to country and project to project, depending on both the characteristics of the country (e.g., size of system) and the form of PPI chosen. *The indicative timetable shown is short, and a much longer one may be needed to deal with project-specific issues.*

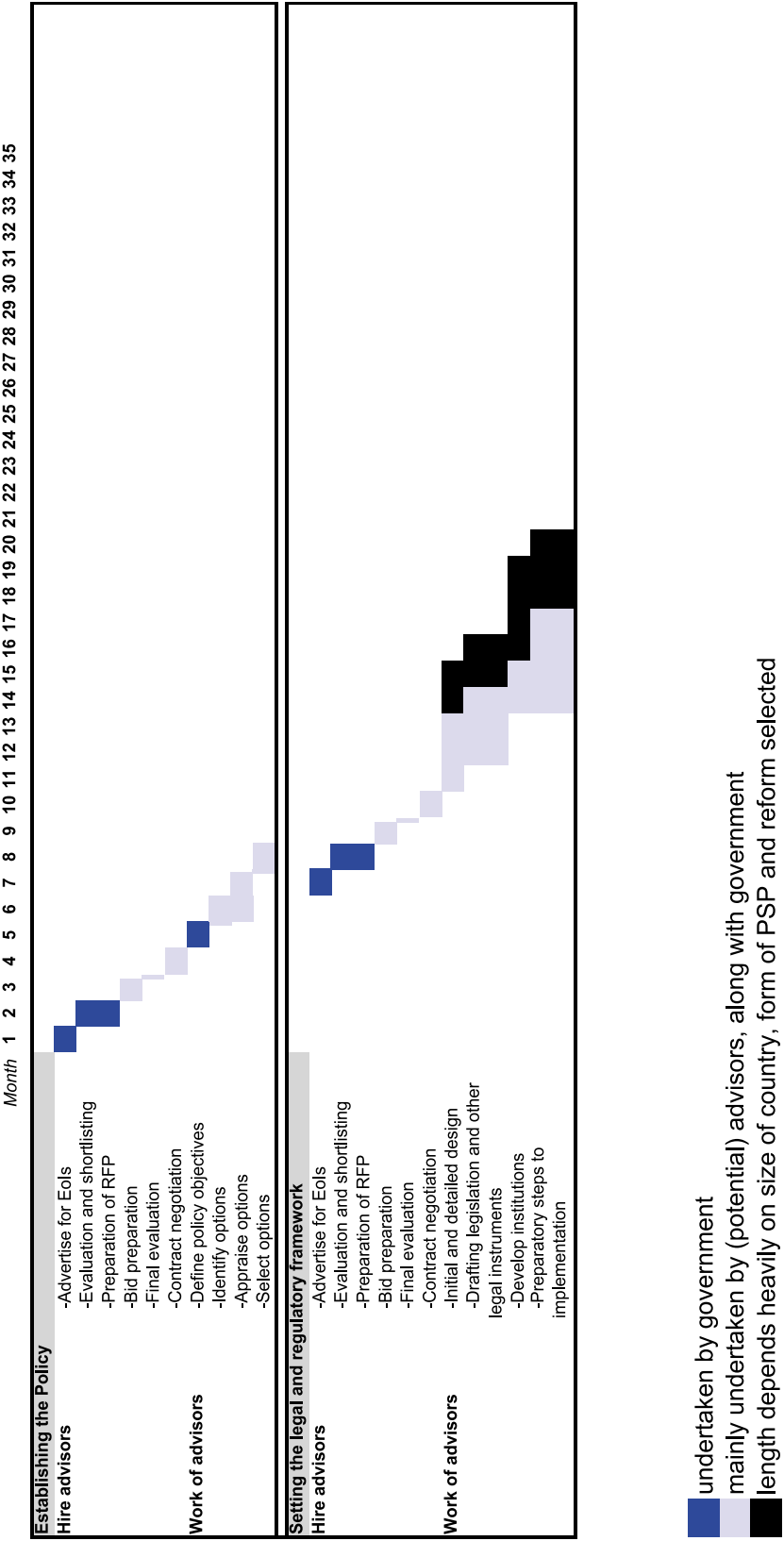
A wide range of decisions may result in a longer or shorter timetable.

Table 4-2 presents an example of alternative reform programs and their impact on the time needed to complete the reform program.

Table 4-2
Impact of sector-specific decisions on timetable

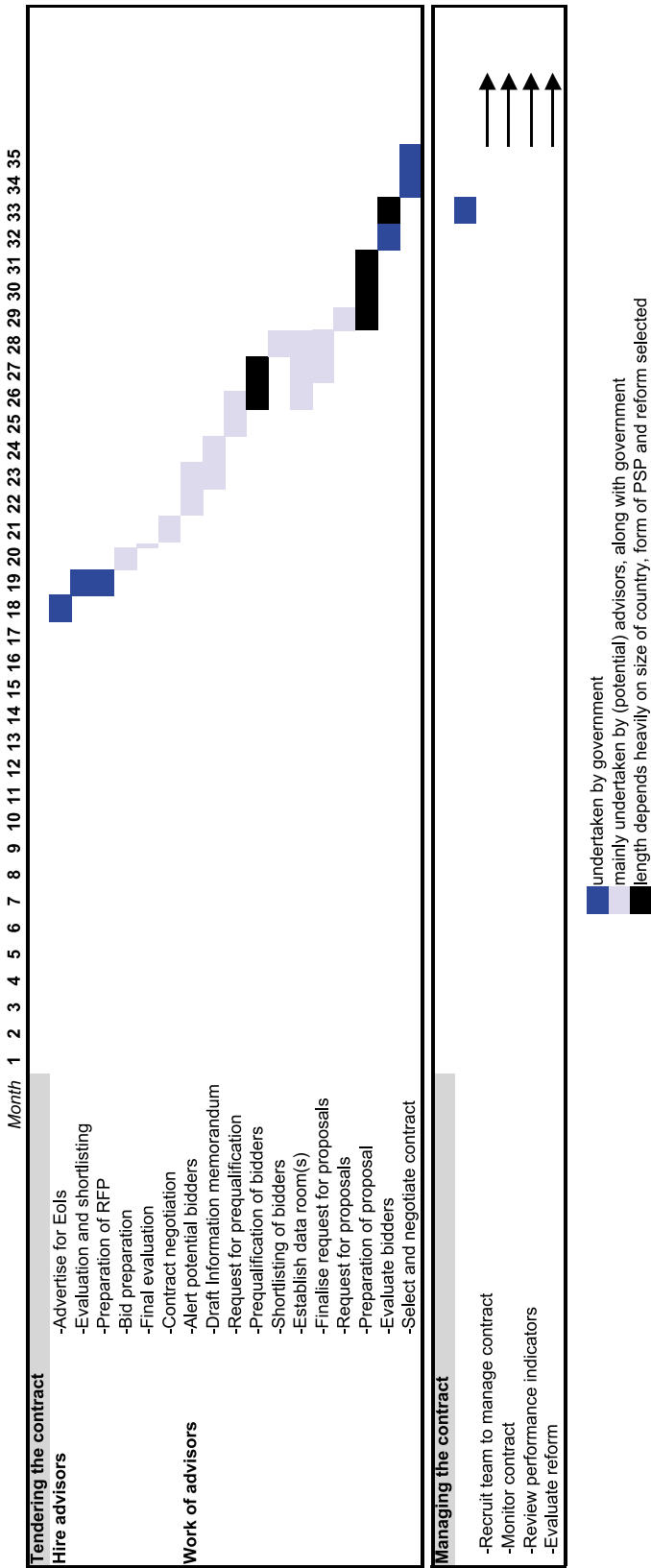
Sector	Relatively shorter time to implement	Relatively longer time to implement
Electricity	Unbundle generation, transmission and distribution and create a single buyer	Unbundle generation, transmission and distribution, and create a power pool
Water	Vertically integrated regional monopolies	Competition in supply
Airports	Landside (e.g., terminal) privatization	Airside (e.g., runway) privatization
Ports	BOT transshipment facility	Competitive terminal's operations within multi-purpose facility
Rail	Concession a high traffic rail line	Create separate private companies for track and rolling stocks
Roads	Pilot toll road (e.g., port to city)	Grouping sets of roads
Telecommunications	Competitive long-distance supply	Local loop unbundling

Figure 4-3
Indicative idealized timetable



undertaken by government
 mainly undertaken by (potential) advisors, along with government
 length depends heavily on size of country, form of PSP and reform selected

Figure 4-4
Indicative idealized timetable



Ensure that the budget matches its requirements

In almost all circumstances, government officials will need to set a maximum budget for payment of advisory services. Ideally, this should reflect the estimated time it will take to complete all of the tasks the government has specified. This means that the budget should be defined after the terms of reference have been drawn up. In addition, the budget should take account of the time required as well as the type of consultants required. Fee rates differ by:

- type of consultancy;
- seniority of the individual; and
- specialization of the individual or company.

Table 4-3 provides an indication of the range of fee rates that might be charged by London-based consultants offering differing advisory services and at various levels of seniority. These are only indicative. The best approach is to draw up the terms of reference and identify the appropriate cost through the proposal process (see Module 6, *Volume II*). In practice fee rates depend on several factors, such as the costs incurred by the company and the availability of similarly skilled individuals.

In some cases, advisors to the government will be paid success fees by the winning bidder, giving them a share in revenues from a transaction. (See *Volume III*.) Where this approach is taken, the advisors can judge whether it is worth risking additional costs on their own account in order to increase revenues and thereby their fees.

Table 4-3

Indicative daily fee rates for London-based consultants, as of 2000 (real 2000 prices)

Position*	Lower bound (US\$/day)**	Upper bound (US\$/day)**
Legal company		
Partner	3400	4000
Senior solicitor	2650	2800
Junior solicitor	1700	2600
Financial company***		
Director/partner	1600	4000
Manager	1300	2400
Consultant	1100	1600
Analyst	800	1300
Economic company		
Director/partner	2300	3500
Manager	1600	2400
Consultant	1100	1600
Engineering company		
Director	1100	2000
Manager	800	1300
Consultant	500	900

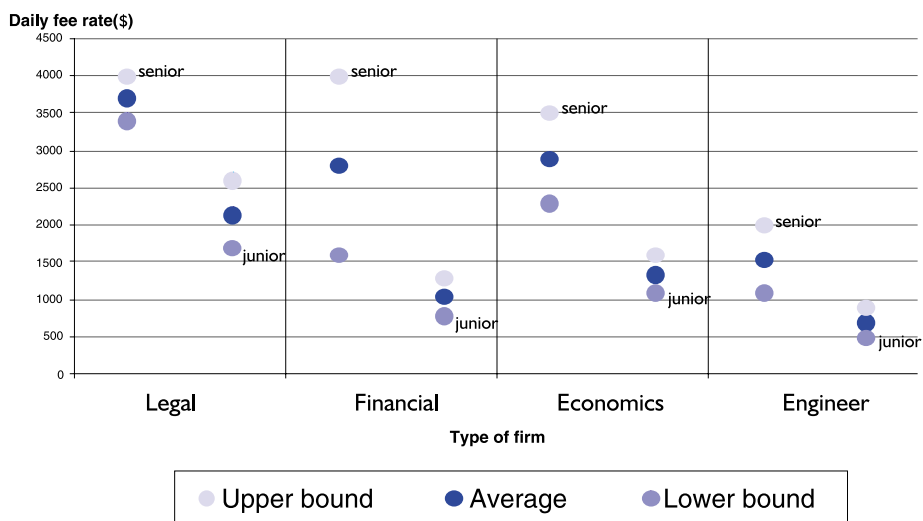
* Fee rates for each position are based on expected years and type of experience. It is clearly possible for someone with very limited experience to set up a company and call themselves a partner. This does not mean that they should be given the fee rates quoted for partners or directors in this table.

**based on 7 working hours per day which is a standard assumption in the UK; 8 hours is standard in the US.

***Financial companies increasingly include a wider and wider range of organizations. The Toolkit emphasizes that the most important factor comprises the skills required for the job. Therefore, in some cases the appropriate financial institution will be the finance division of an engineering company; in other cases the appropriate institution will be a major investment bank. Fee rates are likely to vary widely across this range.

Figure 4-5 illustrates the differences among the cost of the most senior staff in each type of firm. They differ both in the total cost and in the variation of fee rates charged by individuals claiming similar skills. For example, the large variation in the daily fee rate of financial advisors reflects the fact that financial advisors working for an internationally known investment bank will have considerably higher daily fee rates compared to a financial advisor working for a management or engineering consultancy. Module 7 in *Volume III* discusses in more detail the differences among a financial advisor working for an investment bank and one working for a management consultancy and when it may be appropriate to use one or the other.

Figure 4-5:
Indicative range of daily fee rates for director/partner (real 2000 prices)



Note: the same caveats apply to this figure as to Table 4-3.

The requirements set out in the terms of reference (i.e., the skills required, the person-days required, and the balance between senior and junior staff), along with indicative fee rates, should be used to estimate the required budget for the project. Section 4.5 outlines the implications for the terms of reference of budget constraints. If the budget is constrained, the balance of the team and total time inputs will have to be partly determined by the limits imposed by the fee rates.

In general, the fee rates reflect the market value placed on the skills offered—if the same skills were available at a lower rate, the offerer would win the contract. At the same time, most donor agencies, either explicitly or implicitly, work on the basis of multipliers. The multiplier is the amount by which a company's base salary costs are multiplied in order to derive fee rates. There is no generally accepted multiple and many agencies do not use them as a guide, relying instead on competition and market signals to ensure that fee rates are as low as possible (see Modules 7 and 8 in *Volume III*). However, multipliers are generally within the range of 2 to 6 times salary, with engineers and accountants at the lower end of the scale and lawyers and strategy consultants at the higher end.

In practice, budgets are often determined before the terms of reference are drawn up. It is vital in this case to limit the scope of work in order to ensure that it can be undertaken to the required quality within the budget provided. This is discussed in more detail in Section 4.5.

Recommendation 4.1: Officials should write the terms of reference to ensure the project can be properly undertaken within the available budget.

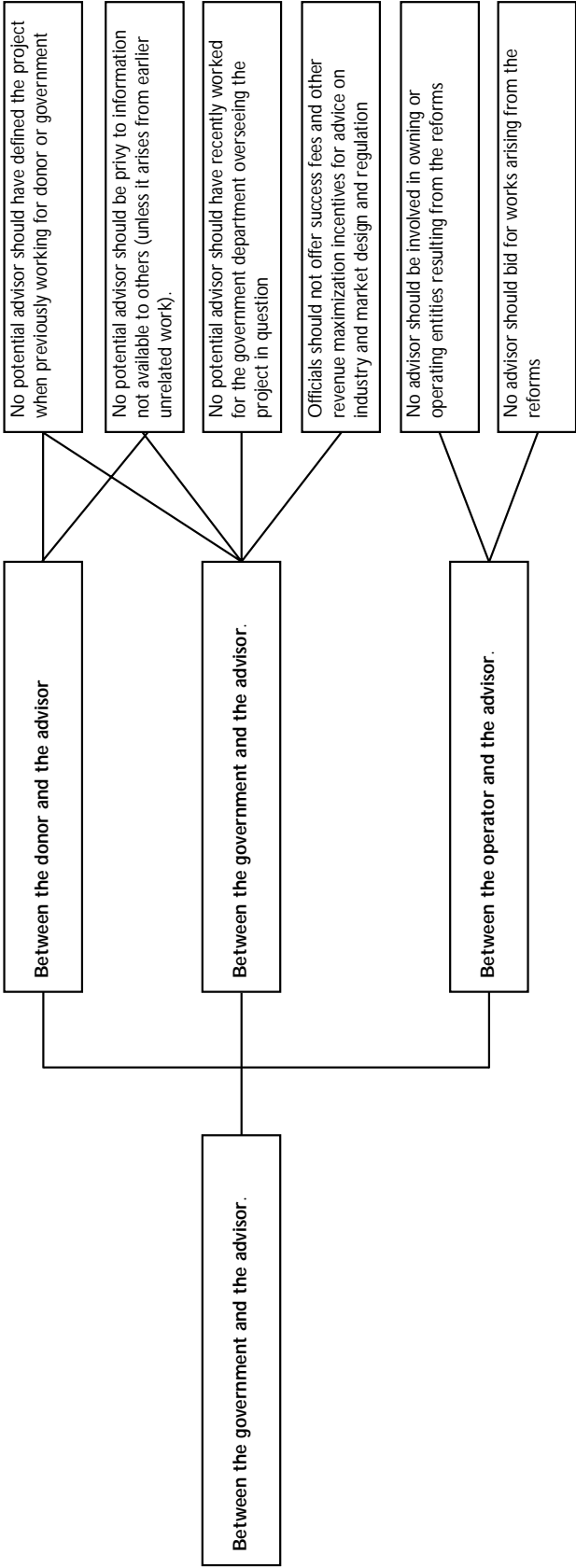
4.2 Resolve conflicts of interest

Government officials must assure themselves that safeguards are in place to preserve fair and open competition. Officials should consider, and take measures to eliminate any possibility of a conflict of interest arising at any stage in the process. Officials should be aware of the range of possible conflicts before hiring advisors. Conflicts of interest may arise among:

- donors and advisors;
- government and advisors; and
- advisors and future contractors/operators.

The main types of conflicts are outlined in Figure 4-6.

Figure 4-6
Potential conflicts of interest



Conflicts arise when the advisors are not motivated solely to meet the objectives of the project in question. The credibility of the process depends both on whether the advisors do in fact have a conflict of interest and on whether there is a *perception* of a conflict of interest.

Assessing whether a conflict exists is therefore not necessarily a clear-cut decision. The key issue is: *Will the individual or company concerned be motivated to meet the objectives of the government?*

A common approach to avoid both actual conflicts of interest and the perception of such conflicts is the use of Chinese walls. *Chinese walls* are created within companies (especially larger companies likely to be working on multiple projects within the same country) to prevent commercially sensitive information flowing from the parties involved in the project to other parts of the company. Although they have been relatively common for many years, they are an increasingly discredited means of avoiding conflicts of interest and should be considered with caution (see Module 7 in *Volume III* for a more detailed discussion).

Another way to avoid conflicts of interest is through the appropriate grouping of tasks. For example, problems can arise if advisors drawing up the terms of reference or the proposal documentation might also be strong contenders for the contract. This is more likely if a large number of advisors (all of whom might be strong candidates for inclusion on the shortlist of potential consultants) provide small amounts of advice.

Finally, separating the development of the regulatory framework from transaction support can help to minimize conflicts of interest. This avoids the possibility of the advisor recommending a regulatory framework that will maximize sale revenues and the advisor's success fee, but which may not be in the best interests of the reform program.

Recommendation 4.2: Every project contains potential conflicts of interest. A person on the government team preparing the terms of reference and then monitoring the project should be charged with identifying and resolving any conflicts of interest.

Disqualification of advisors

Disqualification of advisors involves the elimination of advisors from the bidding process for reasons other than that they are not the preferred bidder.

It is important that the grounds and procedures for disqualifying advisors are both clear and transparent. It is also desirable, if disqualification is to occur, for this to happen as early on in the process as possible, possibly at the pre-qualification process. Examples of the reasons for disqualification on the grounds of conflict of interest may include the following:

- If any advisor on the government shortlist has worked for one of the potential investors on related issues. In addition, if advisors are not willing to commit to not working for potential bidders in any projects arising from the advisory work.

- If involvement at earlier stages of the PPI process has given advisors access to information that would put them in an advantageous position in the bidding process, or which would have affected their judgement at the time had they known they were to advise a bidder.
- If any advisor has received bribes from potential bidders.

In some cases there may be dual use of the same advisors by both the private and the public sectors. Where this is the case, government officials should consider whether it is possible to share advisors in such a way as to avoid conflicts of interest. Although the South Africa case study below indicates that the shared use of advisors can be beneficial, this is only likely to happen under very limited circumstances.

Shared use of advisors in South Africa

As part of the Igoli 2002 initiative, the newly-formed Greater Johannesburg Metropolitan Council (GJMC) is in the process of privatizing or contracting out various utility services. This includes the sale of the local gas distributor, Metro Gas, which was purchased by a consortium of Cinergy and local interests in August 2000.

At the time of calling for bids, no framework for the regulation of the gas industry following privatization was in place. The bid documents included a provision asking bidders to make initial proposals on the appropriate form of regulation. Following the award of the contract to Cinergy, GJMC and Cinergy jointly commissioned economic consultants to assist in the preparation of the regulatory framework as part of the negotiation process. The consultants undertook the actual process of developing the framework, including by-laws and a license, in close co-operation with both the municipality and the private investor.

A key objective of the GJMC was to minimize the regulatory burden. The result was a regulatory framework that focuses on the use of a five-year price cap for sales to smaller and more vulnerable consumers, rather than time-intensive annual reviews (which may also decrease incentives for efficiency gains by Cinergy). The use of consultants is also in line with the policy of GJMC regarding regulation, which envisages a small regulatory unit with extensive support from external consultants.

More generally, there may be a wider range of reasons for disqualification of advisors beyond potential conflicts of interest. Here disqualification may arise because potential bidders have provided false information in their bids about their previous work experience. In addition, as described in Module 6 in *Volume II*, many of the donor agencies may have additional eligibility criteria for awarding loans or grants that provide further grounds for disqualification.

While it is important to have transparent rules about disqualification, application of the rules will inevitably be prone to interpretation. For example, if interpreted conservatively, the rules against conflicts of interest could lead to the disqualification of most large advisors because at least one person in the organization is likely to be in a position of conflict. Therefore, it is important to build into the process some mechanism for appeal to avoid the risk of inappropriate disqualification.

The potential for scope-creep

Scope-creep occurs when consultants advocate either an unnecessary broadening of the terms of reference or make recommendations which are not necessarily in the best interests of the government but which will generate further work for the consultants. It is a form of conflict of interest because it is usually in the financial interest of an advisor to attempt it but not in the best interest of the government. The term also applies when consultants with a specific assignment use their relationship with officials to market their firms for work outside their specialization. Scope-creep may be difficult to identify. Some ways in which it can occur include:

- Advisors advocating full investment plans or management plans for a state-owned enterprise which is about to be transferred to the private sector;
- Advisors suggesting further work that might be of interest to other companies that are part of the same group; and
- Advisors recommending overly complicated legal and regulatory frameworks to ensure that the government is forced to rehire them to assist with the implementation and use of the frameworks.

Although there is no single solution to scope-creep, it is important to note that some contractual arrangements are more likely to lead to scope-creep. For example, Time-and-materials contracts provide built-in incentives for advisors to extend the length of their employment, while lump-sum and success-fee contracts provide fewer incentives for scope-creep (see Module 7, *Volume III*). One of the best ways to avoid scope-creep is to insist on proper knowledge transfer, which ensures that local companies, government officials and regulators can take over once the consultants have completed their initial contract.

4.3 Payment methods need to balance security and incentives

The government must decide on the form of remuneration for advisors before beginning the selection process. There are a number of approaches including success fees, lump-sum contracts and time-and-materials payments. Module 8 in *Volume III* outlines the different payment methods in detail.

Irrespective of the method, consideration should be given to the phasing of payments. In general, companies will seek to be paid up front for reasons of both cash flow and security. Advisors often incur substantial costs up front, both directly in travel expenses and indirectly from staff time. As a result, companies prefer to receive a portion of the lump sum or an advance on time and materials on signature of the contract. They may also prefer up-front payment where there is a possibility that the government will default on a payment. The solution lies in recognizing which costs it is reasonable to expect advisors to bear up front and the incentives necessary to ensure good performance. For large, long-term projects it would be unreasonable to expect advisors to work for an extended period without payment. This is especially true for projects that involve relatively high up-front costs (e.g., those requiring travel).

The shorter the timeframe for the project and smaller the direct up-front costs, the less likely the advisors are to demand an up-front payment. Meanwhile, the government should concentrate on releasing payments based on outputs. In order to meet both concerns, it is common to make the first larger payment contingent on an interim output that is produced near the start of the project, although it may be

necessary to make an initial payment during the mobilization period, when advisors incur significant costs (e.g., travel). This may be an inception report outlining relevant issues and the approach to be adopted or a workshop or other presentation outlining the approach. Forcing advisors to produce outputs early on in the project meets the concerns of cash flow payments and is good project management, ensuring mutual understanding between the advisors and the government.

Recommendation 4.3: The request for proposals (see Module 7 in Volume III) should clearly indicate the payment schedules and, where they are contingent on a specific output, the output should be identified.

4.4 Advisory services can be packaged

Before tendering, it is important to decide whether projects that require many skills should be put out to tender as:

- several small projects broken down by the required skills; or
- a single large project requiring many skills.

Breaking the project into several small assignments enables the government to choose the best advisors for each specific task but has two important disadvantages:

- (1) It increases the project management role of the government, which must manage not only many smaller projects but also the interaction between each of the projects. If a single company or consortium wins a contract then the lead company manages all the inter-relationships.
- (2) It makes timing the different studies critical and also requires companies previously unknown to each other to work well together.

Again, the use of a single company or consortium to undertake the work internalizes many of these problems (i.e., the consortium's project manager is responsible for ensuring the different components are undertaken in the correct order), although it adds a layer of outside management between the government and the analysts.

If a consortium is required (as opposed to a single company with sufficient expertise to cover all the required skills) it is important to clarify a further question: Should consortia be joint ventures or a set of companies subcontracted to a lead company? In general, a joint venture creates a new company in which each individual company has a stake. This new company interacts with the contracting agency according to a hierarchy agreed by the parties.

The alternative is to form a subcontracting arrangement, in which one company will be designated as the lead company and the others subcontract to it. The contracting agency deals only with the lead company (e.g., all payments are made to the lead company which also issues all reports) and the lead company manages all the other companies in the consortium (e.g., paying them for their work and managing their inputs).

Joint ventures are more common in PPI itself than in advisory work. For advisory firms, the added cost and legal complications of a joint venture often outweigh the advantages. It is much more common for consortia to present themselves with a single lead company. If this is the case, then it is common to request that the proposal include a brief letter from each subcontracted company agreeing to be subcontracted to the lead company should the consortium be awarded the contract.

By avoiding pre-formed consortia the government can choose the best company in each area. This is more common when a government is tendering indefinite quantity contracts (see Module 8 in *Volume III*). In indefinite quantity contracts, the length of the contracts and the skills required are unknown when the call for proposals is issued. Post-selection team building (i.e., asking companies to submit proposals for the elements of a project they feel best able to undertake and then forming a team from the best proposal for each section) is the best option for contracts of this kind.

However, in most other situations (i.e., where it is possible to define the task precisely) pre-formed consortia should be favored. One of the most difficult aspects of successfully completing a project is the ability to manage a consortium. Therefore, the government should encourage companies to form consortia that they know successfully undertake the project and allow them to assume the risk of managing the consortium. If the evaluation reveals that one member of the consortium is unable to carry out its assigned tasks, the consortium should be eliminated by the technical evaluation.

This raises a further issue. In some very specialist areas (e.g., pension advice) there may only be a few qualified companies (see Module 3). In addition, if the government wants local participation, there may be a limited number of qualified local companies (e.g., qualified local investment banks or anti-trust lawyers). Requiring pre-formed consortia if there is a very limited number of companies able to carry out a particular task may limit competition among the other companies because the number of consortia is limited by the number of companies able to undertake the specialist task. One way around this is to allow small specialist companies or local companies to associate with more than one consortium, thereby removing this obstacle to the competitive process.¹⁷

Recommendation 4.4: Pre-formed consortia are favorable unless it is difficult to define the skills required at the outset.

4.5 Meeting constraints

So far this section has outlined best practice. However, it is important to recognize the constraints under which governments and other agencies operate. Frequently, budgets will be set at the beginning of the financial year or based on funds remaining to the department. The terms of reference will be set when a budget is already in place.

The government should keep in mind the budget when drawing up the terms of reference. The temptation is to write the terms of reference for the ideal study, while ignoring budget constraints, and then force the winning company or consortium to meet the terms of reference within the given budget. This is a recipe for disaster. The work may not be completed. If it is, the quality will suffer.

¹⁷

It should be noted that companies may be reluctant to share information about the proposal with competing consortia (i.e., with other companies that are part of several consortia) for fear that the information will find its way to other companies. If companies are allowed to associate with several consortia they should accept that they may not be provided with the full details of the proposal until after the final decision

In addition, the companies most likely to submit proposals for under-budgeted work will be those willing to offer a lower quality output or those trying to break into the market and therefore willing to make a loss on the project. Neither is particularly satisfactory.

To avoid these problems, the required scope of work may need to be adjusted to match the limited budget. This is likely to mean eliminating some areas of study from the terms of reference. In deciding what to eliminate, the government body should ask the following questions.

- Are any of the tasks or analysis not critical to the implementation of the PPI program in question?
- Can government staff undertake any of the tasks or analysis?
- Can more junior people, local advisors or lower cost specialists carry out some of the tasks or analysis?

The final question tries to eliminate a common problem. It is tempting to always demand the most experienced, senior individuals from the companies submitting proposals. However, these are also the most expensive. To minimize the cost and increase the amount of time that companies can devote to the project, it is vital to use the more expensive, senior people appropriately (e.g., not requiring them to attend meetings or undertake analysis that could be properly undertaken by cheaper, less senior staff).

Projects can be divided over more than one financial year. Splitting a reform program in this way enables the government to meet annual budget constraints while also meeting the needs of the project. If a review of the scope of work reveals that all tasks are crucial, the government should seek additional funds to complement those available from the budget or the primary source (see Module 6, *Volume II*).

Useful reading

Robinson, C. and N. Wainwright, *Taking Procurement Seriously, new policies for government purchasing*, Public Money, March 1986.

Guasch, J.L. and R. Marshall, *Competitive Provision of Goods and Services to Government by Private Sector in Developing Countries*, World Bank note, November 1993.

5. Use of advisors for small-scale projects

Outline of this Module

What this Module does:

This Module outlines the special features of selecting advisors for smaller scale projects—either projects in small countries or in small political units of larger countries (e.g., municipalities). The Module outlines the main challenges in hiring advisors in small countries and how best to overcome those challenges. It also examines the implications of smaller projects for the stages of the PPI process.

Who should read this Module:

Leaders and officials of small countries, local communities and regions where the reform of relatively small systems is being contemplated should read this Module.

5.1 Definition of a small project

There is no single definition of a small region or small project. The British Commonwealth uses a threshold based on population to define small countries. All those with a population below 1.5 million are considered small and a few additional states are also included because they have characteristics similar to small states (e.g., Jamaica, Lesotho, Namibia and Papua New Guinea). Other organizations use similar definitions. For more detail see Further Readings.

There are two primary kinds of small PPI projects: those in small countries and those being developed at a community level. The difference will affect the method of hiring advisors and the attractiveness of the project to the market. The sections below address the implications for advisors being hired to work in each of these environments.

Small country* → *small project

The typical characteristics of projects that are small because of country size are:

- **remoteness and insularity** – e.g., Mauritius, Maldives and many Pacific island states are located far from major markets, making it more expensive for investors to transport needed materials;
- **limited institutional capacity** – small states find it more difficult to meet the fixed costs associated with building some civil society institutions increasing the risk to investors (e.g., through the lack of a regulatory framework); and
- **limited diversification of production**—small states often have a small resource base and industrial sector concentrated in a few areas, thereby increasing the risk to investors of any adverse market conditions.

Difficulties of smallness

Kiribati has a population of around 80,000, spread over a region roughly the size of Europe. Most of this area is ocean, further challenges the country's infrastructure: transport across the country is difficult, communications and power development are poor, and there is a lack of secure, nonsaline water.

The nearest large markets are 4,000km away in Honolulu and Brisbane. The resource base is small, with little potential for agriculture. The survival of the economy rests on

fishing, which accounts for the livelihood of around 80% of the households and is a major source of foreign exchange. This is used to purchase other necessities.

These conditions may require a different approach to attracting investment for infrastructure. Small systems and local participation with minimum regulatory requirements would be key ingredients of a PPI program, and the scope and size of advisory services would have to be tailored accordingly.

Source: Small States: Meeting challenges in the global economy, World Bank, April 2000.

Community → small project

Even within large countries, there may be a range of small projects undertaken by local communities—municipalities, towns, cities and even regions. These projects face similar problems to those outlined above but also have their own specific qualities, including:

- the potential for support from a larger governmental entity for PPI programs; and
- more restrictions as a result of national policy and law. For example, while stage 1 of the PPI process, as described in Module 2, consists of establishing the policy, it is unlikely that a project undertaken by a local community will change national policy.¹⁸ Under these conditions, much of stage 1 can be omitted, whereas a similarly small project undertaken by a small country should consider stage 1.

The reasons for a project being small will affect the cost of advisors, stages of project implementation, and the use of advisors. Each of these is discussed in Sections 5.2 below.

5.1.1 Cost and small projects

Module 4 presents indicative costs for technical advisory services. Regardless of the project size, the agency responsible for the PPI project will want to minimize costs. This is one of the main justifications for the competitive bidding procedures described in Module 7 in *Volume III*. However, for smaller projects, the need to decrease the costs of technical assistance and other costs associated with PPI is more apparent for two reasons:

- (1) **Upfront costs** Governments in charge of small projects usually face more severe fiscal constraints than larger government entities. As a result, even if the implementation of the PPI program will raise substantial revenue, the government may not want to spend large amounts up front on advisory services.
- (2) **Cost-benefit tradeoff** For very small projects, the tendering of large advisory contracts, including international roadshows and extensive modeling, may result in the costs outweighing the benefits of the PPI.

Consequently, smaller projects must look for ways to minimize the costs of technical advice, while ensuring they receive the advice required for a successful PPI program.

¹⁸ In some cases, projects undertaken by municipalities, such as the water concession in the small town of Limeira, Brazil, may subsequently be regarded as examples of best practice and as such may affect national policy.

5.2 Project implementation

Small country → **small project**

A small country implementing, or anticipating, infrastructure reform should still consider each of the steps for project implementation outlined in Modules 2 and 3. In particular, it should:

- **establish the policy (stage 1)**, clearly identifying both the government policy and appraising alternative options for meeting the policy requirements;
- **set the legal and regulatory framework (stage 2)**, designing and drafting the requisite laws and institutions;
- **tender the contract (stage 3)**, alerting, informing and contracting potential investors; and
- **manage the contract (stage 4)**, monitoring the implementation of the project.

The main savings in this case come not from omitting or combining tasks but from combining and simplifying the role of advisors. This is discussed in Section 5.3.

Community → **small project**

Projects that are small because they are undertaken at a sub-national level will be able to shorten, adjust and, in some cases omit, some of the steps outlined in Figure 2-1. Figure 5-1 to Figure 5-4 outline the main changes to the steps outlined in Figure 2-1. The timeframe for the whole process (and therefore for individual steps) will also change. In particular, stages I and II should be considerably shorter because:

- the identification of the relevant national policies is faster than drafting new national policies;
- the range of options to appraise is likely to be smaller;
- the design of the project is likely to be less complex;
- except in unusual circumstances, any new legal drafting should be straightforward (e.g., projects may necessitate changing local designations for land from residential to commercial but should not require major legal drafting); and
- the government should minimize the creation of local institutions, with tasks assigned either to national institutions or dealt with in contracts between the local authority and the new investor (which are then enforced by national courts).

Figure 5-1

Changes to stage 1 (changes indicated in blue)

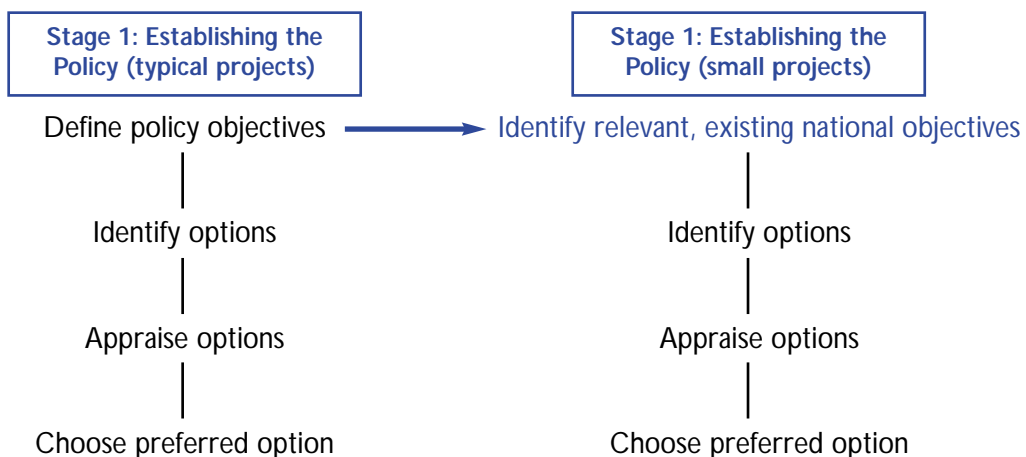


Figure 5-2
Changes to stage 2 (changes indicated in blue)

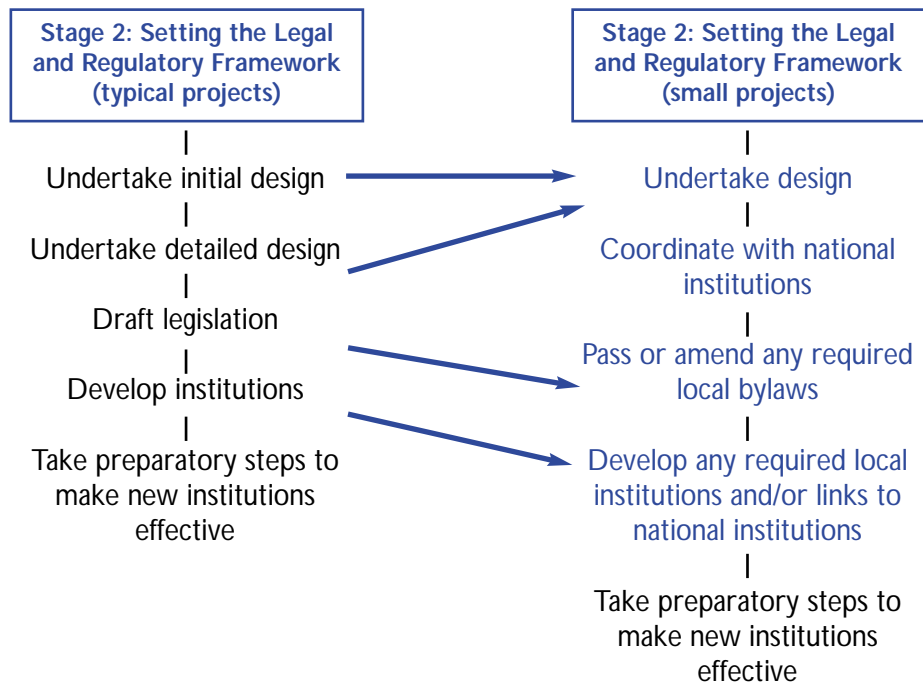


Figure 5-3
Changes to stage 3 (changes indicated in blue)

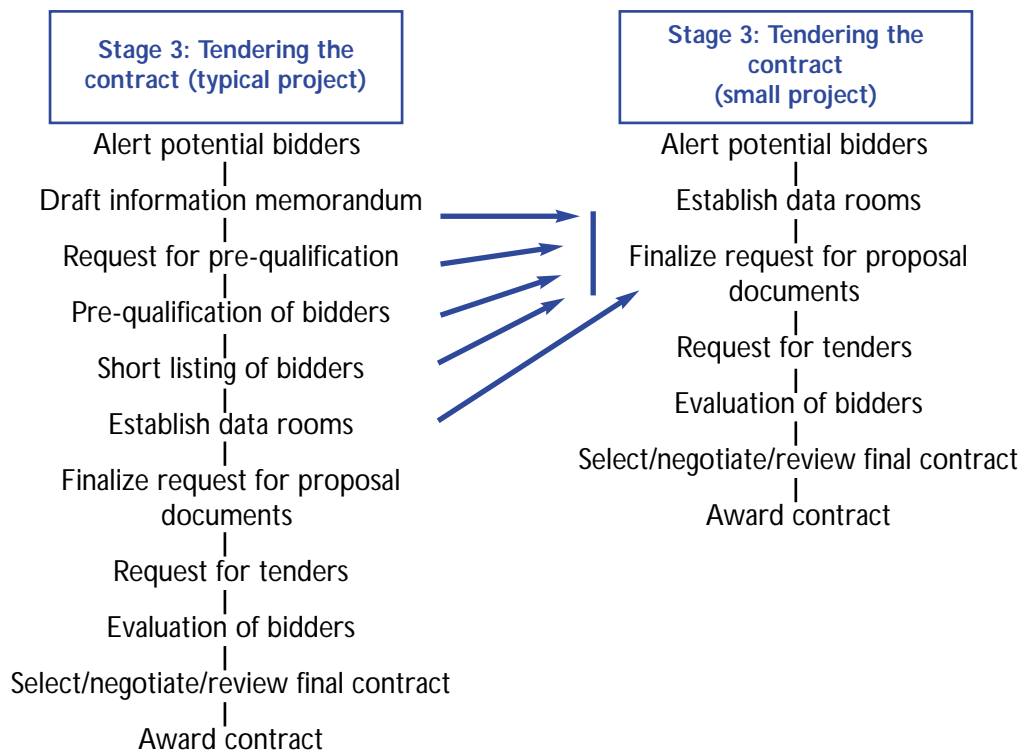
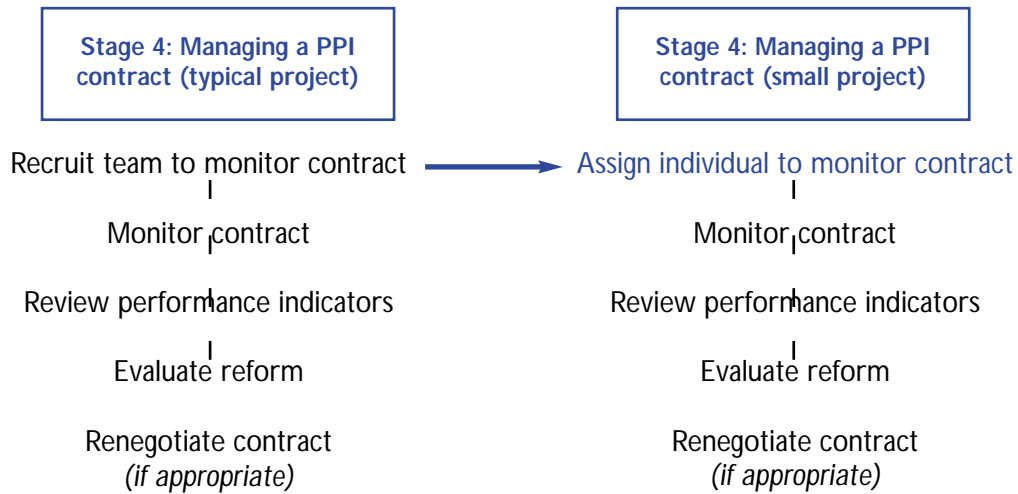


Figure 5-4
Changes to stage 4 (changes indicated in blue)



5.3 Role of advisors

Module 3 outlined the role of advisors in each stage of a PPI project. This section outlines areas in which small projects can lower advisory costs in some of these stages. In addition to eliminating some stages and combining others, advisory costs for small systems can be lowered by recognizing that:

- the use of some types of advisors are unnecessary; and
- the resources required for advisory services need to be scaled down.

Targeting potential advisors appropriately

Recently, a small country in Eastern Europe issued a request for proposals to privatize its telecommunications company. Because the company was to be privatized through a public offering, with the majority of shares likely to be bought by a single strategic investor, only investment banks were invited to bid. However, because of its small size the privatization did not interest the investment banks, none of which submitted a proposal.

A better process would have recognized that the skills required for a small initial public offering can be found outside investment banks. Shortlisting based on skills would have probably included the larger management consultancies, in addition to the smaller investment banks, resulting in more bids.

The main savings will come from two areas.

- **Eliminating the need for some advisory services** Some steps, including detailing the regulatory framework, establishing the regulator, drafting legislation and undertaking investor surveys, may be unnecessary at the community level. While small nations may not be able to eliminate as many advisory roles as community-based projects, they can combine advisory services across many sectors.

- **Combining some advisory roles** While larger, more complex projects require specialist economic, financial, legal, and technical advisors, some of these advisors may be able to take over roles usually performed by others in smaller, less complex projects. For example, Lesotho's Privatization Unit has used management consultants to conduct transactions.

There is another area in which savings can be made: some of these advisory roles may no longer require external advisors. For example:

- state and central government officials with previous experience (and contact with advisors) can undertake some of the tasks (e.g., selecting the appropriate form of PPI, drafting information memorandum, shortlisting);
- using existing material (e.g., model contracts) may reduce the role of advisors (see Module 4 for more detail); and
- in the case of smaller states, the government may use staff within donor agencies who can provide initial guidance on the appropriate approach to adopt or even assist with the transaction.

5.3.1 Eliminating the need for some advisory services

In addition to the reduction of tasks outlined in Section 5.2, the total input from advisors can be reduced by taking advantage of centralized procurement strategies. The first involves procuring services required by a number of communities or small states from one central source. In addition to spreading the fixed costs, centralized procurement:

- may reduce total costs if there are economies of scale in either the procurement or provision of services;
- may increase the interest of established advisory firms that otherwise would not be interested in a single small project;
- creates greater communication among communities and between communities and the national government; and
- provides a forum in which to disseminate advice and experience.

Similarly, grouping PPI reforms across smaller nations can create cost savings both during the advisory stage and during implementation. It may also attract more private sector interest because it is possible to offer larger projects.

Grouping PPI

Grouping across countries—The East Caribbean States

The five member countries of the Organization of East Caribbean States (St. Lucia, Dominica, Grenada, St. Vincent and the Grenadines, and St. Kitts and Nevis) have adopted a new approach to liberalizing their telecommunications sectors. Each island nation considered itself too small alone to undertake the necessary advisory work and reforms. They are therefore undertaking the reforms together.

They received a total of US\$6 million in financing from the IBRD and IDA to undertake the reforms. The result is a regional telecommunications regulator, the Eastern Caribbean Telecommunications Authority (ECTEL). In order to maintain national sovereignty, powers over licensing and regulation remain with each country but the ECTEL will provide technical expertise, advice and support to coordinate regulation across the countries. The ECTEL will also help to ensure that the PPI process is transparent, competitive and protects the interests of consumers. Some OECS state are now pursuing the regional regulatory concept for water, power and broadcasting.

Source: Small States: Meeting Challenges in the Global Economy, World Bank, April 2000.

5.3.2 Combining some advisory roles

In addition to the methods described above, combining some specialized tasks may reduce advisory costs.

Module 3 outlined in detail the skills required at each stage of PPI. Figure 5-5 outlines how the skills required at each stage of the PPI process can be combined in areas where smaller projects allow sufficient overlap to permit one specialist to assume the role of another.

Figure 5-5
Amalgamation of advisory roles

Stage 1: Establishing the Policy	Stage 2: Setting the Legal and Regulatory Framework	Stage 3: Tendering the contract	Stage 4: Managing a PPI contract
Advisors for typical project (see Module 3)			
Economic Financial Legal Technical	Economic Financial Legal Technical Environment Pension HR	Economic Financial Legal Technical Environment Pension HR Procurement	Economic Financial Legal Technical HR
Potential result of amalgamation of advisory roles			
* undertaken internally, either by Economic Technical	local or national government Economic Legal Technical	Financial Legal Technical	None* or Legal

Water privatization in the Windward Islands: A case of scaling down to match the limited resources of an island economy

In preparing for the privatization of its water utility, the government of a Caribbean island nation of 150,000 citizens recognized the need to hire technical advisors to assess the sector's long-term investment requirements. The foreign engineering consultant advising the government on the scope of investment needs determined that the assessment should consist of several sub-components, analyzing possible options for such variables as network linkage between different regions, extension of distribution pipes, and development of sewerage systems in most of the island's communities. The proposed assessment called for teams of several engineers and professionals, -including sanitary engineers, mechanical engineers, electrical engineers, economists, and a geologist -providing nearly 1000 person days of work and costing over US\$800,000.

While it was imperative that the government conduct an investment needs analysis to determine average tariffs and to carry out a successful transaction, the scope and cost of this analysis threatened to overwhelm the government's resources. The government determined that the study as described would be too complicated and costly given its restricted resources. Accordingly, the design of the study was modified: the technical advisors will rely on an outline engineering appraisal to derive cost estimates for each variable, and will not assess all possible options or verify some assumptions used in the appraisal. Re-scoped, the final technical analysis will cost closer to \$250,000 and will be closely coordinated with the financial work in order to maximize economies of scope with the transaction advisors.

A final option available to all small projects is the use of the potential investors to reduce the cost of the PPI process. Many potential investors have consultancy divisions that may undertake many of the tasks described in Module 3 at a discounted rate because the parent company is interested in the investment opportunity. While this can be a cost-cutting option, it must be used very carefully because of the clear potential conflicts of interest involved. The only reason potential investors may offer their consultancy services at a discount is because they see a potentially profitable opportunity in the future. It is vital that impartial, experienced individuals carefully check the advice from any such consultancy before implementing any of the advice. One approach to minimizing costs may be to hire a recognized expert to review the advice received from a potential investor. Regardless of the precise approach, because of the potential conflicts of interest this route should only be adopted if the advantages of PPI are clear and other options for minimizing the cost of advisory services are not available.

5.3.3 Eliminating and combining advisory roles

Combining similar projects—either across sectors or across municipalities or small countries—allows those overseeing small projects to eliminate some roles and combine others. It is possible to:

- eliminate repetitive tasks (e.g., the same group of investors may be contacted about several opportunities for water privatization in different towns); and
- combine similar tasks (e.g., principles of tariff design may be similar across many sectors).

Combining Projects to Spread Costs

Public Private Partnerships Program (4Ps), UK

There is an extensive program of PPI (called the Private Finance Initiative because it extends beyond infrastructure) in the UK. The central government encourages each of the local authorities (community governments overseeing populations ranging from around 100,000 to about 400,000) to use the private sector to increase efficiency.

The central government recognized from the beginning that use of the private sector would entail some fixed costs, which were likely to discourage local authorities from implementing the program. Therefore, the government established a quasi-public agency, the 4Ps, to provide assistance to the local authorities and allow some of the fixed costs associated with PPI advisory services to be spread across multiple projects. In addition to spreading the costs and providing support through the PPI process, it also provides a focal point for the private sector, creating greater private sector interest in an individual project than the same project would generate had it simply been advertised by the local authority.

For more information see <http://www.4ps.co.uk/>.

Coordinating Council for Private Sector Participation (CCPSP), Philippines

In 1989, the Coordinating Council of the Philippine Assistance Program (CCPAP—later renamed CCPSP) was created to mobilize and use development assistance to the country. In this capacity, CCPAP supported around 100 pre-investment studies covering a wide range of infrastructure and other industries. It provided not only a central coordinating center for potential projects and for communities looking at new projects, but also provided assistance in overcoming problems of implementation.

It helped to resolve right-of-way issues, provided auditing services, ensured environmental compliance and undertook general administrative functions. These administrative functions included the creation of a computer-based project-monitoring program.

For more information see: http://members.xoom.com/op_ccpsp/.

Recommendation 5.1: The size and scope of small projects alter the role, selection and use of advisors. In particular, governments should limit the cost of advisors by combining tasks and projects wherever possible.

5.4 Role of the competitive tendering process

Module 7, *Volume III*, discusses the competitive selection process. There are four main points around the competitive hiring of advisors:

- It is often the best way to ensure the appropriate quality advice at the lowest price;
- It involves initial costs necessary to undertake the process (although longer-term savings are likely);
- It requires some expertise on the part of the selectors; and
- It must be interesting to a sufficient number of companies to create competition.

(For a fuller description see Module 7, *Volume III*)

However, the competitive appraisal of potential advisors for small projects will differ in a number of important ways. In particular:

- the size of the projects may limit the number of interested companies;
- knowledge of the projects is likely to limit the number of bidders; and
- lack of experience on the part of the selectors will probably require simplified submission, evaluation and contracting procedures.

Of these, the largest obstacle will be the size of the project. Small projects mean that spending on advisors must also be small if the benefits of the projects are not to be outweighed by the costs of implementation. There are a number of approaches to limiting the cost of undertaking a competitive bid:

- **National Competitive Bidding** Rather than advertising and issuing international requests for proposals, this entails a national competition. Clearly the ability to do this depends on the expertise that exists within the country. However, once combinations of foreign and local advisors have undertaken larger PPI projects then there may be sufficient local expertise to advise on the implementation of small projects.
- **Listing** A variation on indefinite quantity contracts, listing requires a central government authority to maintain a database of companies that have been used in the past or have expressed interest, along with their areas of expertise. As specific projects arise, invitations can be sent to a few companies extracted from the database. As a result, the project moves immediately to the proposal evaluation stage.

This approach also limits the costs to companies of bidding for small projects. Companies are more likely to be willing to provide relevant details once for a database than each time a small project arises. Therefore, in addition to creating databases for municipalities and towns, small states should consider combining resources to create regional databases of potentially interested companies.¹⁹ It is vital that these databases are kept up to-date.

- **Coordinating** Communities or small states wanting similar services should coordinate a joint request for proposals and share the associated costs. This has the further advantage of increasing the size of the project, which will therefore attract greater private sector interest.

Coordination of resources

In Uganda the government is setting up a Rural Electrification Unit (REU) that will be responsible for coordinating rural electrification funding and advice. Communities will be responsible for bidding for funds from the REU and those awarded funds will then benefit from the REU, which will coordinate all the projects, and provide advice and central procurement for equipment and other needs. This approach will combine the benefits of community-led PPI while using a centralized procurement strategy to allow competitive selection procedures without imposing all the costs on a single community.

¹⁹ All the major multilateral donor agencies already keep databases of registered consultancies. Since any consultancy can register (provided they meet minimal criteria) the databases should not be regarded as an endorsement of the companies and the proper selection procedures should still be carried out. However, these lists provide a starting point if, for example, a call for expressions of interest has not solicited enough interest (see The role of donor agencies in PPI for the web addresses of the organisations).

In addition to variations on the bidding process, communities should also consider whether it is cheaper to contract individuals rather than companies. Individuals may be cheaper to hire because their use simplifies the bidding process (i.e., they submit a CV and a description of how they would approach the work), and have lower fee rates. In addition, if three or four individuals are well known, the shortlisting exercise is made easier. However, it is important to recognize the limitations of using individuals. They are unlikely to be able to offer the range of services provided by a company. Individuals are likely to be more appropriate to small, focused tasks.

Finally, communities should also consider sole-sourcing projects that are so small that the savings from competitive outsourcing are outweighed by the costs of the process. However, sole-sourcing should always be approached cautiously. (See Module 7 in *Volume III* for more discussion on when to sole-source projects.)

5.5 Risks

The relatively small size of these projects creates some important risks. These should be acknowledged and form a basis for the design of the detailed PPI process. In particular, the level of expertise available is likely to be lower because more experienced experts and companies are attracted to larger projects. There are a number of ways of mitigating the risk of hiring bad advisors:

- by including a representative from the government or donor agencies with past experience of similar projects on the evaluation and project management team (e.g., a representative of the state or central government with experience of previous programs for municipal projects; and a representative from a donor or the region for small nations' projects);
- by asking for previous reports, presentations and other references from the proponents; and
- by providing the advisors with incentives to perform well (e.g., a bonus partly contingent on successfully implementing the project, see 'How to select and manage PPI advisors').

Useful Reading

Franceys, R. *Private Participation in the Water and Sanitation Sector*, UK Department for International Development, Occasional Paper #3, 1997.

Gopal, G. *Procurement and Disbursement Manual for Projects with Community Participation*, World Bank Discussion Paper 312, 1995.

Commonwealth Secretariat and World Bank Joint Task Force on Small States. *Small States: Meeting Challenges in the Global Economy*, 2000.

Glossary

Advisor	An individual or company providing information analysis and/or recommendations
Analysis	The production of a report or statement setting out the underlying reasons for or causes of a particular event or outcome
Bait and switch	The practice of enticing a client by promising the participation of particular individuals and, once the client is committed, switching the promised individuals for others
Billing schedule	Description of when and under what conditions invoices (bills) can be submitted
Bottom line	In financial proposals, the minimum acceptable level
Bribe	Receipt of anything, monetary or otherwise, in return for an action that would otherwise be prohibited
Chinese wall	Measures put in place to prevent the flow of specified information from one individual, or set of individuals, to another individual or set of individuals add within an organisation
Competition	Three main forms: in the market, the normal attempt to attract customers for your good as opposed to another similar good, for the market one off contest to provide services to a particular group, may be repeated at intervals, contestability pressure from potential new entrants. Also yardstick (or comparative) for regional monopolies imposed by only allowing tariffs based on costs of other, similar, companies (e.g., power and water distribution)
Concession	Contractual arrangement that transfers responsibility for asset management and new investment
Concessionary lending	Lending below the prevailing market interest rate or for a longer term for the type of loan in question
Consensus	A generally held point of view
Conflict of Interest	This arises when parties have incentives not to behave in the appropriate manner due to the influence of other interests or projects
Consortium	Group of companies—usually with a single lead company and others subcontracted

Consultant	See advisor
Contract	A formal, written agreement that creates legally binding or enforceable obligations on some or all the parties
Corruption	Accepting a bribe (see bribe)
Covenant	Agreement, promise or guarantee, as in a financial covenant requiring a sum of money be set aside as a guarantee for certain actions
Current cost valuation	Value of an asset based on the cost of acquiring the same asset today
Divestiture	To sell a controlling interest
Donor	Agency that lends money at a concessionary rate. Often divided into multilateral, where lending is controlled by many countries, and bilateral, where lending policy is controlled by one country.
Drawdown contract	See Indefinite quantity contract
Due diligence	Investigation and assessment of a potential project or assets
Economic value	Discounted expected net cash flow
Efficiency	Distribution of resources to their most valuable use—generally divided into three types: productive, in which a given output is produced at minimum cost given existing inputs at a point in time; allocative, in which inputs are assigned to activities where they are most useful at a point in time; and dynamic ,in which inputs are assigned to their best use over time.
Evaluator	Person marking proposals, bids and other submissions
External Advisor	Advisor from outside the organization (also see Advisor)
Feather-bedding	This occurs when advisors unnecessarily expand the terms of reference
Fee rate	Charge for the time of the advisor, excluding all expenses (see also Per Diem, Reimbursable)
Financial instrument	The transfer of risk, such as long term bonds and insurance

Financial proposal	Sets out the monetary terms required to undertake a project
Fixed fee	A single fee for delivering an output that does not vary (e.g., does not change depending on time it takes to deliver the output or other costs of output)
Framework contract	See Indefinite quantity contract
Grant funds	Funds lent that have no interest payment attached to them and are not to be repaid, a gift
Greenfield project	A project built from scratch, i.e., without building on an existing or older similar project (e.g., a new water treatment plant)
Gross Domestic Product (GDP)	Total value of all output produced within a country
Historic cost	Value based on the actual cost of acquiring the existing assets
Hydroelectric	Electricity generation based on the kinetic energy of water
Implementation	Putting in place
Indefinite quantity contract (IQC)	Contract for an unspecified amount of work, usually over a few years
Industry restructuring	Altering the relationship between organizations within a sector (possibly including dividing single organizations into multiple parts)
Infrastructure	The underlying physical structure of a country, often with monopoly elements and usually involving the delivery of goods, people or information. For the purposes of this Toolkit, these include power (electricity generation, transmission and distribution, and gas distribution); sanitation (water, sewerage and solid waste services); telecommunication networks; and transportation (seaports, airports, rail, roads and bridges).
In-house expert	Expert who already works within the organization
Intellectual property	An original idea belonging to an individual or company
International competitive bidding	Selection based on a competition for which companies based outside the host country are eligible

Investor	Company or individual who invests (usually money) into a project in return for future rewards
Invitation to Tender	See Request for Proposals
Knowledge transfer	Passing of information from one party to another
Lease	A contractual arrangement in which responsibility for the operation and management of an asset is conferred (see also Contract, Concession)
Letter of invitation	An introduction to an offer to submit a bid
License	A series of legal requirements that must be signed prior to being allowed to participate in a sector (see also Contract)
Loss leader	A project undertaken in the knowledge that it will make a loss, because it will establish the company or individual in the market
Lump sum	See Fixed fee
Management contract	An agreement to manage a company without assuming any responsibility for investment or asset maintenance (see also Lease, Concession)
Market value	Value of an asset, company or idea based on its sale price
Mini-proposal	A brief statement by a company or individual following a shortlisting for a project on a specific topic. May be used instead of a proposal or as a second stage to create a smaller shortlist.
Model	A representation of something on a larger scale
Modern equivalent asset value	Value of an asset based on the cost of replacing it with a modern asset that can perform the same task(s)
Multinational companies	Company with production in more than one country
Natural monopoly	Occurs when the cost of producing a given output decreases as more output is produced within a single firm; used to justify the inefficiency of competition in the market (see also Efficiency, Competition)
Objectives	Goals, aims
Per diem	A daily payment to cover expenses

Performance indicator	A test applied to determine whether expected targets have been met
Policy	A course of action adopted by a government
Pre-qualification	Creation of an initial set of requirements that must be met before a party can bid for the project in question
Private Participation in Infrastructure (PPI)	The introduction of the private sector into the provision of some aspect of infrastructure deliver or services (see Infrastructure, Service contract, Management contract, Lease, Concession, Divestiture, Natural monopoly)
Private sector participation (PSP)	Introduction of the private sector to a particular area of the economy or a specific project
Procurement	To obtain, acquire
Public good	Good where the benefits of its provision cannot be limited to those who pay for it and where its use does not limit the quantity or quality available to others.
Regulator	Individual or agency that oversees a sector—may oversee the economic, technical and legal aspects or some subset of them
Regulatory framework	Legal and economic setting within which a regulator works
Reimbursable	Costs that the advisor can recover from the client
Remuneration	Sum of fee rate and reimbursable expenses (see Fee rate, Reimbursable)
Replacement cost	Value of an asset based on the cost of replacing it
Request for Proposals	A call to submit a proposal for a particular project
Request for tenders	See Request for proposals
Retainer	A fixed fee paid to an advisor for being available to provide advice on a specified issue over a particular period
Risk	Chance
Road show	Presentation of a project or set of assets in a number of cities nationally or around the world with the aim of raising interest or awareness of an opportunity (usually an opportunity to invest)

Select	Choose
Service contract	Contract to provide a specific service, such as information management associated with the operation of a company
Shortlist	A list of individuals or companies allowed to bid for a project
Social goals	Goals generally associated with the distribution of wealth
Sole-sourced	Granting a project, the right to do something or a set of assets to a single party without undertaking a process by which multiple parties can bargain for the right (see International competitive bidding, competition)
Stakeholder	An individual or company with an interest in the issue
Standing charge	A tariff that is independent of the volume consumed
Stranded cost	A cost that cannot be recovered because of a change in market conditions beyond the control of the company in question
Success fee	Payment based on a percentage of the price for which assets (or the right to do something) are sold or on the amount of finance raised for a specific project
Technical assistance	Provision of information and/or advice
Technical proposal	A document setting out the approach that would be adopted to a particular project, along with the individuals and/or companies who would carry out the approach described
Time and materials	Payment based on the amount of time taken to undertake a given task and the cost of the materials used
Track record	Past experience
Transaction cost	The cost of agreeing to undertake something
Transparent	Everyone has access to the same information about the process in question
Unanimous	Everyone in agreement
Up-front costs	Costs, usually fixed, that must be incurred prior to beginning to undertake a project or task

Utility

Company or organization that provides electrical or water services

Value for money

Creation of an outcome (an objective) at minimum cost

Toolkit:

A guide for hiring and managing advisors for private participation in infrastructure



Donor agencies and the funding of PPI advisory services



Table of contents

Section	Page
6. Funding agency requirements	1
6.1 Outline	1
6.2 Agencies	4
6.3 Multilateral sources of funds for technical assistance	7
6.4 Targeted Trust Funds for Infrastructure	18
6.5 Fundamentals	22
6.6 Eligibility of advisors	25
6.7 Competitive selection requirements for advisors	27
6.8 Advertising and shortlisting	29
6.9 Use of individuals	31
6.10 Agency requirements for selection	33
Annex 1: Acronyms and abbreviations of bilateral institutions	36
Glossary	37

6. Funding agency requirements

Outline of this Module

What this Module does:

This section describes the main multilateral and bilateral lending agencies and presents some detailed information about their lending policies and the sources of funds available for technical assistance. It also provides addresses where further information can be found.

Who should read this Module:

The module provides a guide to where a procurement officer could turn for funding. It can be used to identify 2-3 agencies to approach. Consequently, it should be read by procurement officers and project developers unfamiliar with the donor agencies and their lending and granting practices.

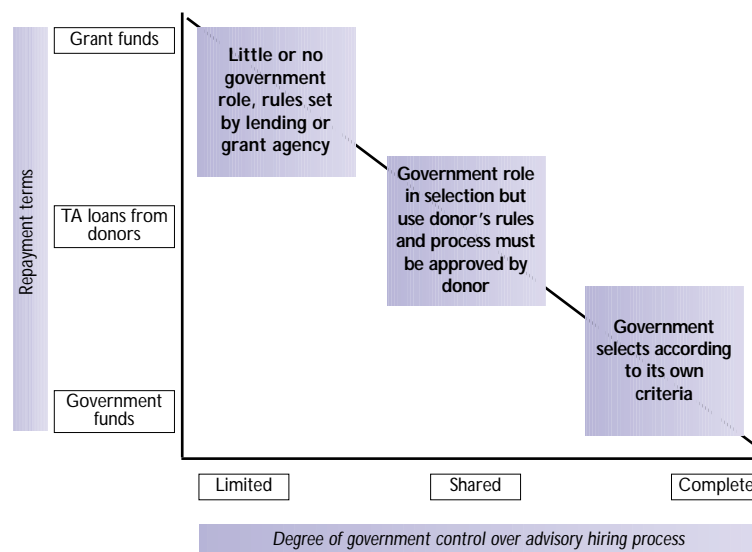
In this Module, and throughout the Toolkit, donor agency is used to refer to all bilateral and multilateral lending and grant giving agencies.

6.1 Outline

Funding agencies invariably attach terms and conditions to the money they lend or provide as grants. Consequently, it is important to understand these terms and conditions in order to ensure that the appropriate agency is approached. While the other sections of this Toolkit present best practice in selection, in practice, **if money is received from these agencies then governments will be bound by their selection rules.** Figure 6-1 summarizes this idea.

Figure 6-1

Relationship between source of funds and government control over selection



There are several important reasons to turn to an external source for funds to carry out technical assistance. Funding agencies have:

- funds to supplement those from a government's internal sources;
- expertise in the procurement process that the government can use to ensure it hires appropriate advisors; and
- experience in project management that the government can use to ensure the advisors it hires perform satisfactorily.

At the same time it is important to recognize some of the trade-offs of using the agencies. In particular, the selection process:

- is often slow, especially when a government is not fully aware of all the correct procedures; and
- places certain restrictions on the government (e.g. on the eligibility of potential advisors and the evaluation process).

After understanding the requirements of different agencies, it will be important to weigh these advantages and disadvantages given the specific project under consideration.

Finding funding for technical assistance is, in some respects, similar to procuring the services themselves. Funding is provided by a wide range of agencies, each with specific mandates for the use of their funds. These mandates depend on the nature of the project, its location and the type of services required. Consequently, depending on the use to which the funds will be put, different agencies will be more or less appropriate. A shortlist of potential funding agencies should be prepared, followed by more detailed investigation of the costs and benefits of using their funds.

Agencies will typically have different procurement rules for goods, services and technical assistance. In keeping with the rest of the Toolkit, this section outlines those relevant to the selection of technical assistance. It presents the main highlights of the rules. Internet addresses from which more detailed information can be obtained are given at the end of each subsection.

Donor agencies can be divided into three main categories: multilateral lending agencies, and bilateral aid agencies, and trust funds and other agencies. Each has its own set of rules and procedures. While there are minor differences on a wide variety of points, the main differences can be summarised under six headings¹:

- (i) eligibility for funding;
- (ii) the terms under which the agencies provide funds (i.e. the requirements for repayment);
- (iii) hurdle requirements for competitive selection;
- (iv) requirements for advertising and shortlisting firms for new projects;
- (v) evaluation of proposals; and
- (vi) use of individuals (rather than companies).

6.2 Agencies

Most developed countries have bilateral aid agencies and/or trust funds that provide funds to developing countries and non-governmental organizations involved with poverty alleviation. In addition, many governments contribute funds to multilateral donor agencies that then on-lend the funds, on both market and concessional terms, to developing governments.

¹ However, because of the differences in other areas (e.g. rules for associations, definitions of conflict of interest) this Module should only be used as an introductory guide. Full procurement guidelines should be read before negotiating for funds with one agency.

In recent years, aid agencies have come to recognize the importance of the private sector in providing infrastructure services. They have shifted away from public lending programs to areas of infrastructure that would instead attract private investment. As part of this change in focus, the donor agencies have come to play a pivotal role in helping developing countries to redefine the role of state, restructure markets, develop regulatory institutions and bring in private sector managers, operations and investors in infrastructure services.

The main multilateral agencies involved in PPI are summarized in Table 6-1.

Table 6-1
Main multilateral agencies

Agency	Contact details	Aid Coverage*	Technical Assistance lending, US\$ million (year ending)=
World Bank: IDA/IBRD	http://www.worldbank.org/	Global	706 (1999) ^
United Nations Development Program	http://www.undp.org	Global	371 (1997, approx)
Asian Development Bank (ADB)	http://www.adb.org/	Asia	173 (1999)
Inter-American Development Bank (IADB)	http://www.iadb.org/	Central/South America and the Caribbean	106 (1998)
African Development Bank (AfDB)	http://www.afdb.org/	Africa	60.8 (1998)
European Bank for Reconstruction and Development (EBRD)	http://www.ebrd.com/	Eastern Europe, Former and Current Soviet States	596.6 (1998) ^ ^
European Union (PHARE, TACIS)**	TACIS, PHARE: http://europa.eu.int/comm/external_relations/tacis/intro/index.htm http://europa.eu.int/comm/enlargement/pas/phare/index.htm	TACIS: former Soviet states, Russia and Mongolia PHARE: Eastern Europe,	TACIS: < 430 (1998) ^ ^ PHARE: < 900 (1998) ^ ^
Caribbean Development Bank (CDB)	http://www.caribank.org	Regional members cover the Caribbean	< 50 (est, TA not separated from project lending)

*: Membership often includes states outside the region in which the organization provides funds.

** : The EU also has a regular TA program run through the Commission. Funding from the program depends on bilateral agreements between the EU and the government in question.

^ : Excludes trust funds managed by the World Bank which disbursed approximately US\$1.3 billion in fiscal year 1999.

^ ^ : Based on Euro 1.15 = US\$1; (est, TA not separated from project lending)

= : Technical Assistance to all sectors, not just infrastructure.

N/a – Not available.

The main bilateral agencies are summarised in Table 6-2.

Table 6-2
Main bilateral agencies

Country	Agency*	Contact details	Coverage	Total ODA (US\$ m, 1998)
Canada	CIDA	http://www.acdicida.gc.ca/index.htm	Global	1,363.7
Denmark	DANIDA	http://www.um.dk/	Mainly sub-Saharan Africa	1,132.9
France	AFD	http://www.afd.fr/	Mainly North and West Africa	4,679.9
Germany	GTZ	http://www.gtz.de/	Mainly Africa	3,729.9
Japan	JBIC	http://www.jbic.go.jp/	Mainly Asia	8,646.9
Norway	NORAD	http://odin.dep.no/ud/engelsk/index-b-n-a.html	Mainly Africa	1,002.3
Sweden	SIDA	http://www.sida.org/Sida/jsp/Crosslink.jsp?d=107&a=4827&v=7	Mainly sub-Saharan Africa and South Asia	1,145.4
Switzerland	SDC	http://194.230.65.134/dezaweb2/home.asp	Global	997.0 (1999)
UK	DFID	http://www.dfid.gov.uk/	Mainly Commonwealth	2,253.2
USA	USAID	http://www.usaid.gov/	Global	39,632.0

*: Acronyms and abbreviations are explained in Annex 1.

In addition to these agencies there are a number of targeted managed funds that have been set up, either in conjunction with one of the agencies or as independent entities. These are discussed in detail in Section 6.4.

6.3 Multilateral sources of funds for technical assistance

The multilateral agencies offer several types of support. Money lent for technical assistance may come as one component of a larger sectoral or structural adjustment loan or may be a self-contained sum of money either in the form of a loan or a grant (e.g. from a trust fund). This section provides an overview of the main sources of funding for technical assistance. However, it is not exhaustive and is intended to indicate both where funds may be available and where advice may be sought about other possible sources of funds not outlined in this section.

6.3.1 World Bank

The World Bank Group consists of five closely associated institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Center for the Settlement of Investment Disputes (ICSID). References in this Toolkit to the World Bank refer to the IBRD and IDA.

The World Bank's purpose is to reduce poverty and improve living standards for people in the developing world. The Bank provides loans (or "credits" in the case of the IDA), policy advice based on economic and sector analytical work, technical assistance and, increasingly, knowledge-sharing services to its client countries. The IDA is focused on the poorest countries, to which it provides interest-free loans (known as "credits") and other nonlending services. IDA depends on contributions from its wealthier member countries – including some developing countries – for most of its financial resources. In financial year 1999, 81 countries were eligible for IDA credits, which are made only to governments. IDA lending is legally and financially distinct from IBRD but it shares the same staff and the projects it supports must meet the same criteria. IBRD provides loans and development assistance to middle income countries and creditworthy poorer countries. The IBRD obtains most of its funds through the sale of bonds in international capital markets and is controlled by its membership who vote based on their capital subscription, which is, in turn, linked to their relative economic strength².

A selected example of World Bank projects approved in 1999 that included technical assistance component is presented in Table 6-3.

Table 6-3
Selected examples of World Bank lending

Country	Size and source of funds (in current prices)	Project description
Argentina	US\$30 million, IBRD	To support water sector reforms in medium sized cities with populations of about 50,000 to 500,000, including the introduction of private sector participation in the operation and management of water utilities, adoption of appropriate regulatory frameworks, and implementation of tariff policies and tested investment alternative to better reach poor consumers.
Armenia	US\$21 million, IBRD	To support Phase I of the Power Sector Restructuring and Development Program, which seeks to rehabilitate the electricity transmission and distribution network, reduce losses and the cost of service, commercialize sector enterprises and attract private investment.
Brazil	US\$150 million, IBRD	To support the development of a fully integrated urban transport system by transferring the ownership and management of the Salvador subdivision of the Brazilian Urban Transport Company system from federal government to state and municipal hands.
Egypt	US\$50 million, IDA	To create jobs and provide community infrastructure and services through small-scale public works in partnership with communities and local government, to be executed by small local private contractors. A community Development Program will support education and training.
India	US\$210 million, IBRD	To support Phase I of the Power Sector Restructuring Program by establishing a new legal, regulatory and institutional framework and industry structure, and the preparatory work for privatizing power distribution.
West Bank and Gaza	US\$21 million, Trust Fund for Gaza and West Bank	To improve water and sanitation services in the southern West Bank and implement an appropriate institutional framework for water and wastewater service provision.

² For more information, including membership lists, see the World Bank's Annual Report.

6.3.1.1 Concessional Trust Funds

As the last row of Table 6-3 suggests, the World Bank also oversees many trust funds – financial resources set aside by particular countries for specific uses. There are four main categories of Concessional Trust Funds (CTFs):

- (1) *General Trust Funds*: support activities related to World Bank lending.
- (2) *Environmental Trust Funds*: support the incorporation of environmental consideration into projects and programs provided by the World Bank.
- (3) *Eastern and Central Europe Trust Funds*: support for World Bank projects in Eastern and Central Europe.
- (4) *Special Studies Trust Funds*: support for specific programs or sectors benefiting from World Bank financing.

The CTFs usually come with conditions that tie the use of the funds to consultants from the donor country in question and, sometimes, from the country receiving the funds. They also are often accompanied by more stringent restrictions on the use of former Bank staff than more general operational funds.

6.3.1.2 PHRD Grant Funds

Additional sources of funding are the Policy and Human Resource Development (PHRD) funds provided by the Japanese government. These grant funds were established in 1990. They are one of the largest sources of grant funds for technical assistance and are available to over 130 countries. In 1999, the PHRD provided grant funds for 203 projects totalling US\$95.4 million. The main advantage of these funds is that they can be activated quickly following a government request to the relevant World Bank Country Director. Further information on PHRD can be found at <http://www.worldbank.org/rmc/phrd/phrd.htm>.

The World Bank provides a booklet summarizing its hiring guidelines. Guidelines: Procurement under IBRD Loans and IDA Credits is available from the World Bank's bookshop <http://www.worldbank.org/infoshop>, telephone +1 202 458 5454.

6.3.1.3 IFC Trust Funds

The World Bank Group's International Finance Corporation (IFC) has a separate set of trust funds to providing money for technical assistance: Technical Assistance Trust Funds Program. As with the CTFs a number of countries have set funds aside, most of which are tied to companies based in the donor country. In-keeping with the IFC's mandate, the funds are to be used to:

- help entrepreneurs to prepare business proposals;
- undertake basic fact finding work on behalf of the IFC;
- facilitate private participation in infrastructure;
- provide legal and financial expertise during privatization programs;
- prepare and undertake training programs in areas related to privatization;
- assist in setting up pilot schemes; and
- promote small and medium size enterprises.

The IFC generally lets relatively small contracts (less than US\$50,000) and need not follow many of the procurement guidelines required of other World Bank

organisations (see Sections 6.1 to 6.10). The IFC's Technical Assistance Trust Fund Program is described in detail at <http://www.ifc.org/products/worktatf/worktatf.html>. They can be contacted by facsimile at +1 202 974 4344.

6.3.2 United Nations Development Program (UNDP)

The UNDP's mission is to provide developing countries with knowledge-based policy advice on the entire range of issues that pertain to reducing poverty, building institutional capacity and managing the challenges of globalization.

The UNDP is the United Nations' principal provider of development advice, advocacy and grant support. Its core programs focus on the countries that are home to 90% of the world's extremely poor people. The UNDP has about 130 field offices providing it with a presence on the ground in nearly every developing country. The UNDP also engages in extensive advocacy work about poverty issues.

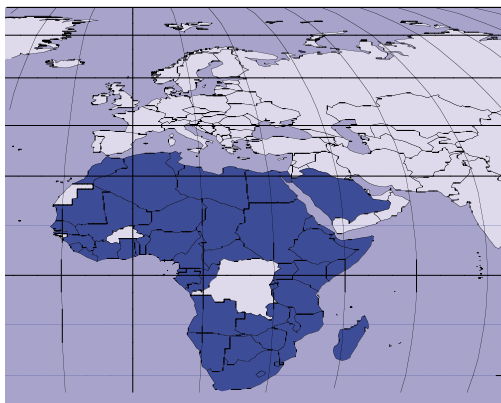
In each country office, the UNDP Resident Representative normally also serves as Country Coordinator of development activities for the United Nations system as a whole.

For more information about the scope of the UNDP's work see:
http://www.undp.org/about_undp/index.html.

6.3.3 African Development Bank (AfDB)

The African Development Bank (AfDB) provides funding for technical assistance projects through two of its three main instruments, the:

- African Development Bank (AfDB); and
- African Development Fund³ (ADF).



The African Development Bank promotes the economic advancement of regional member countries through a variety of programs that include the provision of technical assistance for the preparation and execution of development projects and programs. It covers most sectors but emphasises work in:

- agriculture;
- utilities;
- transport;
- industry;
- health; and
- education.

³ The third instrument, The Nigerian Trust Fund, provides financing for projects, excluding technical assistance, of national or regional importance that promote the economic and social development of low income regional member countries who cannot borrow from the other two funds.

It is also focused on programs that aim to alleviate poverty, better manage environmental concerns, promote gender equality and population studies.

The African Development Fund provides financing in similar areas but on highly concessional terms. It is reserved for countries unable to borrow on the Bank's normal terms. No interest is charged on ADF financing and the principle is normally repaid over a 50 year period, including a 10 year grace period.

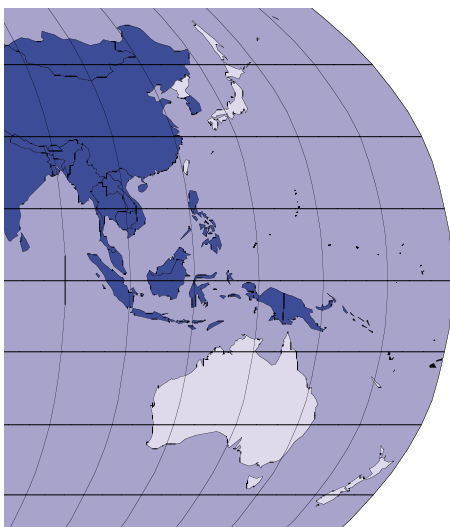
For more information on the AfDB see <http://www.afdb.org/about/afdbgrp/adb.html>.

For more information on the ADF see <http://www.afdb.org/about/afdbgrp/adf.html>.

6.3.4 Asian Development Bank (ADB)

The ADB provides loans to public and private sector clients throughout Asia and the Pacific. It has three main instruments through which it finances technical assistance grants and loans:

- (1) Project Preparatory Technical Assistance (PPTA): to assist developing member countries (DMCs) to develop a pipeline of investment projects suitable for Bank or other financing. This consists mainly of feasibility studies but may also include capacity building, promoting new financial markets and policy reform more generally.
- (2) Advisory and Operational Technical Assistance (AOTA): to assist DMCs undertake proposal evaluation, contract supervision and initial operation and management of Bank-financed projects. This too may include capacity building and the development of national or sectoral policies.
- (3) Regional Technical Assistance (RETA): to promote regional activities, including studies, training, conferences, workshops, research and other regional activities.

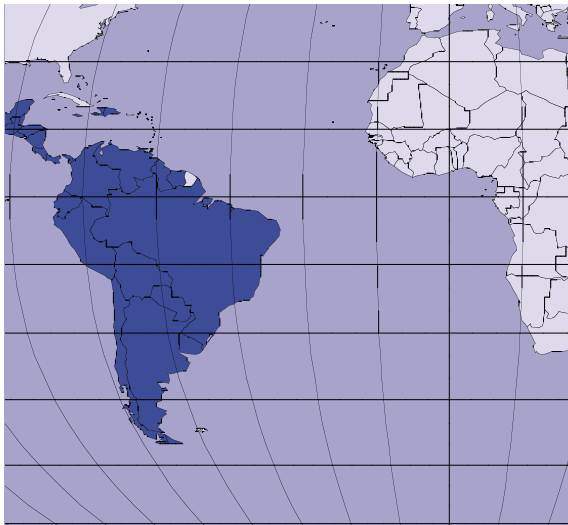


Funding from each of the instruments may be on a grant or concessional loan basis, or a combination of the two. The funds for the grants came from voluntary contributions to the Technical Assistance Special Fund, which includes contributions to the Technical

Assistance Special Fund, which includes the Japan Special Fund (JSF). The JSF was established in 1988 and is used to finance technical assistance on a grant basis in both the public and private sectors. Its main use is to help DMCs restructure their economies and broaden the scope for new investment opportunities.

The ADB provides a booklet describing its technical assistance funding and the use of the various funds. It is available at:
http://www.adb.org/Documents/Others/TA_Activities/tabroch.pdf.

6.3.5 Inter-American Development Bank (IADB)



There are two main sources of funding for technical assistance from the IADB, each with multiple subgroups of funds. The first source is the Multilateral Investment Fund (MIF) which was created in 1993 to encourage the role of the private sector in Latin America and the Caribbean.

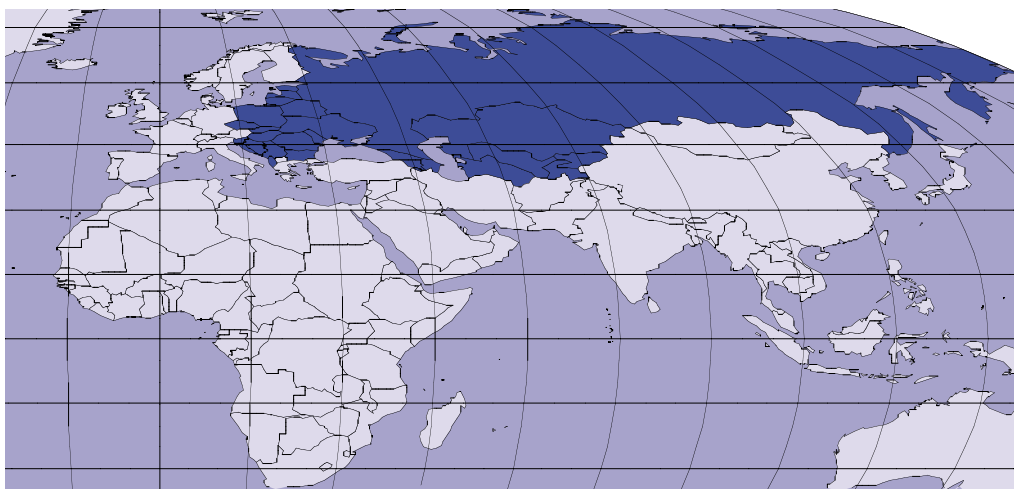
The MIF is discussed in more detail in Section 6.4.4.

The second main source of funding for technical assistance comes from the trust funds administered by the IADB. As with other lenders, the funds have been set up by a wide range of donor countries and provide grants for a range of activities. Of particular interest are the following:

- the Japan Special Fund provides grants primarily for the preparation of projects. Its funds are not tied;
- the Program for Development of Technical Cooperation among Member Countries was set up by several countries to finance short and medium term assignments for consultants and activities such as workshops and training seminars; and
- in-kind trust funds for the direct provision of specialists from public sector institutions from the countries who set up the funds (currently: Brazil, France, Germany, Israel and Spain).

For more information about IADB trust fund programs see:
<http://www.iadb.org/exr/english/ABOUTIDB/Annual/funds.htm>.

6.3.6 European Bank for Reconstruction and Development (EBRD)



The EBRD has three main sources of funds for technical assistance.

- (1) Governments borrowing money from the EBRD may use all or part of the proceeds to hire consultants for a wide range of projects including:
- in the early stages of a project: feasibility studies, environmental assessments, engineering and project design and cost estimates;
 - during project implementation: preparation and evaluation of tender documents and supervision of works; and
 - to conduct studies: sector master plans, export and investment opportunities and marketing.

In addition to using funds from Bank loans two other sources of funding are available:

- (2) The EBRD's Administrative Budget: The Bank can hire consultants directly from its own budget.
- (3) The Technical Cooperation Funds Program: This set of funds is provided by donor countries for technical assistance covering the areas outlined above.

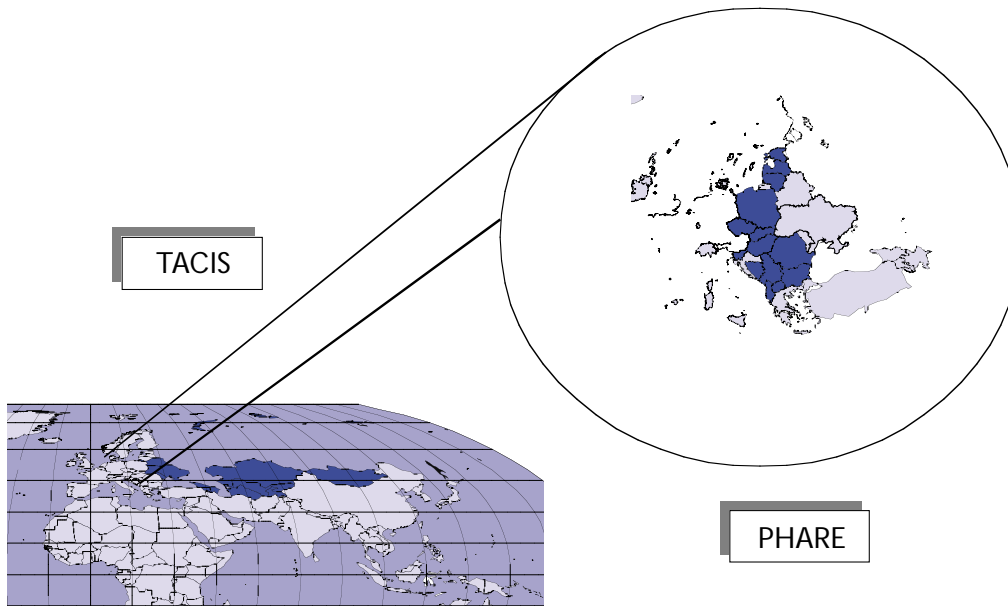
6.3.7 European Union (EU)

The European Union provides a centralized source of funds for technical assistance that has several components. All funds are now managed by the Joint Relex Service which has been given the responsibility for the implementation of the external assistance activities programmed by Directorate General 1A (DG1A) and other external relations Directorates General.

The two main funds for countries outside the current EU are:

- Technical Assistance to the Commonwealth of Independent States (TACIS); and
- Poland and Hungary Assistance for Restructuring Economies (PHARE)⁴.

⁴ Despite its name, the money from this fund is available to other countries, in addition to Poland and Hungary – see full description below.



6.3.7.1 EU TACIS

The break-up of the Soviet Union created a large number of new states and the EU decided to create a fund to support the institutional development of these countries. TACIS is focused on helping the region move towards democracy and developing the region's capacity to operate in an international market economy.

The TACIS program was set up in 1991 to provide this support to the newly independent states of the former Soviet Union:

- Armenia;
- Azerbaijan;
- Belarus;
- Georgia;
- Kazakhstan;
- Kyrgyzstan;
- Moldova;
- Russia;
- Tajikistan;
- Turkmenistan;
- Ukraine; and
- Uzbekistan.

In addition, Mongolia is able to access funding from TACIS.

The EU is in the process of implementing new bilateral framework documents with each of the countries, known as Partnership and Cooperation Agreements (PCAs). PCAs currently exist for nearly all the countries. Only Tajikistan has yet to sign one as of mid-2000. They provide the framework through which funds for technical assistance can be requested. All external assistance projects provided by the EU, including TACIS, can also be accessed through a common service, the Joint Relex Service, of the European Commission.

For more information about TACIS see:

http://europa.eu.int/comm/external_relations/tacis/intro/index.htm.

6.3.7.2 EU PHARE

The PHARE program provides grant finance for knowledge transfer, policy advice and training to the 13 Central and Eastern European countries and the Baltic States. PHARE has assumed added importance with the current process of EU enlargement and it is one of the primary vehicles through which the EU is providing aid to the 10 partner countries that have applied for EU membership. PHARE's aim is twofold: for the ten countries that have applied to join the EU, it is to prepare them for accession. For the other three countries, PHARE's aim is to support their transition to democracy and a market economy.

For the 10 potential EU member states, PHARE grants are coordinated with other aid through bilateral Accession Partnerships (APs). It is through the bilateral APs that PHARE funding should be requested. The three countries which are not currently part of accession talks but which are eligible for PHARE funding (Albania, former Yugoslav Republic of Macedonia and Bosnia and Herzegovina), continue to have direct access to funds from PHARE.

The PHARE guidelines provide it with two main priorities: institution building and investment support. A range of measures and mechanisms have been established in order to provide help in these areas. Preparations for twinning, a key instrument of institution building, got under way during 1998 and the Large-Scale Infrastructure Facility, a new investment support instrument, was also launched during the same year.

For more information about PHARE see:

<http://europa.eu.int/comm/enlargement/pas/phare/index.htm>.

6.3.8 Caribbean Development Bank (CDB)

The Caribbean Development Bank (CDB) is another multilateral institution formed around the Caribbean states in 1969. The CDB is intended to "contribute to the harmonious economic growth and development of the member countries in the Caribbean and to promote economic co-operation and integration among them, having special and urgent regard to the needs of the less developed members of the region."

A complete list of regional and nonregional members can be found at <http://www.caribank.org/CDBWebPages.nsf/pages/Purpose#CDB>.

The functions of CDB are to assist its Regional Members in the coordination of their development programs, including:

- financing projects and programs that contribute to the development of the Region or any of the Regional Members;
- providing appropriate technical assistance to its Regional Members, particularly by undertaking or commissioning pre-investment surveys and by assisting in the identification and preparation of project proposals;
- promoting private and public investment in development projects by, among other means, aiding financial institutions in the Region and supporting the establishment of consortia;
- cooperating and assisting in the regional efforts designed to promote regional and locally controlled financial institutions and a regional market for credit and savings; and
- stimulating and encouraging the development of capital markets within the Region.

The CDB is committed to funding technical assistance, in particular to “assist regional members in the co-ordination of their development programs with a view to achieving better utilization of their resources, making their economies more complementary and promoting the orderly expansion of their international trade, in particular intra-regional trade.” It is also committed to “provide appropriate technical assistance particularly by undertaking or commissioning pre-investment surveys, and by assisting in the identification and preparation of project proposals.” CDB’s TA operations are intended to complement its project operations by facilitating the transfer of techniques, the development of expertise and the identification and promotion of investment opportunities.

Under these provisions, CDB may provide TA to its Regional Member Countries, its subsidiary entities or private entities within its countries. It may also supply TA to international or regional institutions, where appropriate. The TA that CDB extends can be either in the form of grants or loans.

Growing demands for TA prompted CDB to establish a TA Fund (TAF) with an initial endowment of US\$4 million. TAF allowed CDB to increase not only the volume of its TA, but also the scope and, in so doing, to react to requests for assistance not only for project-oriented purposes but also for other areas related to development, including environmental impact assessments and human resource development.

CDB also provides training courses either through the financing of seminars or short courses and also, in special cases, through the award of fellowships.

There is also the Caribbean Technological Consultancy Services (CTCS) Network which provides specialized technical hands-on assistance mainly at low cost to manufacturing enterprises, hotels and service-industries in the Region. It is not focused on infrastructure and so is not discussed here in any more detail. For further information see <http://www.caribank.org>.

6.4 Targeted Trust Funds for Infrastructure

This section presents some of the main targeted trust funds that provide funds for technical assistance services in infrastructure. Table 6-4 provides an overview of the funds spent by each of the funds described in this section.

Table 6-4
Funding for technical assistance by trust funds

Fund*	Amount (US\$ million, year)
PPIAF	15.6 (2000, est)
ESMAP	21.6 (1998)
InfoDev	3.9 (2000, est)
MIF	44.5 (1999, est)

*: abbreviations and acronyms explained in subsections below

6.4.1 Public Private Infrastructure Advisory Facility (PPIAF)

The Public-Private Infrastructure Advisory Facility (PPIAF) is a multi-donor technical assistance facility aimed at helping developing country governments improve the quality of their infrastructure through private sector involvement.

PPIAF pursues its objectives through two mechanisms:

- Channeling technical assistance to governments in developing countries on strategies and measures to tap the full potential of private sector involvement in infrastructure; and
- Identifying, disseminating and promoting best practices on matters related to private sector involvement in infrastructure in developing countries.

PPIAF funding can be used to support activities aimed at facilitating private sector involvement across infrastructure industries, including electricity, gas transmission and distribution, water and sewerage, solid waste, telecommunications, railways, ports, airports and roads. PPIAF can support a comprehensive program of country-specific and multi-country advisory activities in the following areas:

- articulating infrastructure development strategies, including the role of the private sector;
- building consensus for appropriate policy and institutional reforms;
- designing and implementing specific policy and institutional reforms;
- supporting the design and implementation of pioneering projects and transactions;
- building government capacity; and
- identifying, promoting and disseminating best practice.

Application forms for PPIAF funding, examples of past studies, and detailed information about the Fund's operations can be found at:
<http://www.ppiaf.org/>.

6.4.2 Energy Sector Management Assistance Program (ESMAP)

ESMAP is a global technical assistance program sponsored by The World Bank and the United Nations Development Program with financial participation from public and private donors. ESMAP focuses on the role of energy in economic development with the objective of contributing to poverty alleviation and economic progress, improving living conditions, and preserving the environment in developing and transition economies.

ESMAP provides policy advice and other technical assistance to help governments, public institutions and private businesses. It focuses on three priority areas: the development of energy markets, the promotion of environmentally sustainable energy production and uses, and the increased access to reliable, efficient and affordable energy services by unserved or underserved populations with a focus on the poorest.

Since it was established in 1983, ESMAP has supported more than 450 projects, in more than 100 countries. ESMAP concentrates on issues that are not yet part of the main lending programs of other multilateral and bilateral lenders and aims at designing innovative approaches to address energy issues.

Table 6-5 provides a breakdown of ESMAP lending.

Table 6-5

Breakdown of lending by value and number of projects (1998)

Region	Projects	
	By US\$ value	By number
Sub Saharan African	26%	28%
Middle East and North Africa	3%	4%
South Asia	10%	8%
East Asia	9%	13%
Europe and Central Asia	6%	6%
Latin America and Caribbean	36%	22%
Global (i.e. not confined to one region)	10%	19%

Further information is available at: <http://worldbank.org/html/fpd/esmap/>.

6.4.3 Information for Development (InfoDev)

InfoDev is intended to help developing countries to integrate fully into the information economy by providing access to knowledgeable and experienced resources to open the doors to new technologies. InfoDev is a link to the vast network of technical, informational and communications expertise available throughout the world. The program helps to ensure that developing economies have access to information that is relevant, just in time, and above all objective and free from conflicts of interest through its partnership with governments, multilateral and bilateral donors, the private sector and not-for-profit organizations.

InfoDev shares world-wide experience with and disseminates best practices to governments and key decision-makers, both public and private, on the economic development potential of communications and information systems. It channels policy advice and other technical assistance to governments in emerging economies on privatization, private entry and competition, and on improving the policy, regulatory and business environment for investors in communications and information systems. It also conducts feasibility and pre-investment studies and prepares experimental applications in communications and information systems. Table 6-6 outlines the geographic distribution of InfoDev projects.

Table 6-6

Distribution of projects by region (1999)

Region	Projects
Sub Saharan African	22 %
Middle East and North Africa	3 %
South Asia	8 %
East Asia	6 %
Europe and Central Asia	11 %

Region	Projects
Latin America and Caribbean	20 %
Global (i.e. not confined to one region)	30 %

For more information see <http://www.infodev.org/>.

6.4.4 Multilateral Investment Fund (MIF)

The MIF is a special fund administered by the IADB created in 1993 to encourage the growing role of the private sector in Latin America and the Caribbean. In partnership with governments, business organizations, and non-governmental organizations, the MIF provides technical assistance grants to support market reforms; build the capabilities and skills of the workforce; and broaden the economic participation of micro, small and medium-sized enterprises. The MIF also acts as a catalyst to attract capital to the small business and microfinance sectors by investing in special equity funds in community development, venture capital, technology, and business partnerships, as well as funds that promote new directions in the environment.

It provides grants for technical assistance that support:

- market reforms;
- capacity building; and
- participation of micro, small and medium sized companies⁵.

The MIF typically provides US\$100,000 to US\$1,000,000 to projects covering these areas. Increasingly, the MIF is shifting its resources into projects focused on the environment, including the provision of funds for technical assistance to promote improved environmental performance of small and medium size companies.

For more information on MIF see: <http://www.iadb.org/mif/eng/about/index.htm>.

For more information about its shift to supporting technical assistance focused on environmental improvement see: <http://www.iadb.org/mif/eng/strategies/environment.htm>.

6.5 Fundamentals

This section outlines the five main areas in which the multilateral lending agencies may differ, apart from the financial terms under which they lend. The most common characteristic across all the lending agencies is their strong preference for competitive selection. Table 6-7 summarizes the requirements of the different multilateral lenders. It is followed by more detailed information for each of the five main categories.

It is important to note that, both for Table 6-7 and the following sections, the selection rules were correct at the time that the Toolkit was produced (November 2000). The rules are subject to review and change. Consequently, these sections and tables should only be used as a guide to the types of procedures required by these organizations. If a project is being undertaken with one of these organizations it should be contacted for its most recent selection procedures.

⁵ In addition to the technical assistance lending, the MIF also undertakes other activities, including trying to act as a catalyst for equity investment in small and medium size enterprises by investing in special equity funds, venture capital and other instruments.

Table 6-7
Summary of main selection requirements for the hiring of advisors (2000**)

Category	World Bank*	IADB	AfDB	ADB	EBRD
Eligibility: Must firms be registered in member countries?	✓	✓	✓	✓	✓
Competitive Selection Requirements: Level above which competitive selection required	US\$100,000	None	UA350,000	None	Euro 50,000
Advertising: Must competitive tenders be advertised in a specified newspaper?	✓	✓	✓	✓	✓
Use of individuals: Are rules different for individuals than for firms?	✓	✓	✓	✓	✓
Main form of evaluation	Q&C	Q	Q&C	Q	Q

*: Refers to IDA and IBRD. IFC has slightly different requirements – mainly related to the fact that it is never obliged to advertise or competitively bid projects – for details see next sections.

** : Table summarizes situation when the Toolkit was published (November 2000). All rules are subject to change and should be verified with the organization in question.

1 UA= 1 unit of account = 1 SDR = (approx) US\$ 1.4

6.6 Eligibility of advisors

Most of the multilateral lending agencies balance the desire to hire the best company or individual for the job in question with their requirements in terms of country of origin. At the same time, all the agencies encourage the use of local firms and individuals, in part to ensure some transfer of knowledge. In some cases this is encouraged in the marking scheme (see Section 6.10 on Evaluation below). Where there are no explicit allowances, a statement may be included saying that the use of local firms is encouraged.

It is important to note, as outlined in Section 6.3, that technical assistance from trust funds sometimes carries more restrictions on eligibility – funding is sometimes limited to companies based in countries from which the funds originate and to which the funds are being given. Therefore, in considering trust fund financing it is important to check their specific eligibility criteria.

The main eligibility requirements for the multilateral lenders are presented in Table 6-8.

Conflicts of interest

All the lending agencies have requirements that firms providing consulting services cannot subsequently benefit from any contracts for goods or works that result from the consultancy. Many firms that provide goods and works (e.g. engineering products) also have subsidiaries or departments that undertake consulting work. In other cases, potential investors in privatized infrastructure (or greenfield projects) will have consultant teams. Typically, the multilateral agencies will require that if firms or their subsidiaries undertake a consultancy contract, the same firms and their subsidiaries cannot bid for subsequent contracts for goods or works arising from the consultancy.

Table 6-8
Eligibility conditions

World Bank (IDA/IBRD)*	IADB	AfDB	ADB	Europe (EBRD)
Firms registered/incorporated in Bank member countries and there are no prohibitions on commercial relations between borrower and country of consultant. Individual trust funds may limit eligibility.	Firms regarded as nationals of country in which they reside/are registered or headquartered. Other determinants of nationality are nationality of majority owners or beneficiaries (same applies for nonprofit organizations). Cannot hire a permanent or temporary member of government entity or member of staff of Bank within last six months.	No limitations on origin of firms but strong emphasis on the use of local firms and individuals. Locals can be part of more than one consortium, but, if subcontracted to a consortium, should not make up more than 25% of the total contract price.	Two funds- Ordinary Capital and Special Funds, only firms from member countries can get funds from the Ordinary Capital Fund. Nationality requirements to access Special Funds are defined at the time of use (e.g. Japan Special Fund, see Terms and Eligibility).	No limitations (i.e. firms from any country can be awarded projects) but shortlist should not normally contain more than two companies from the same country and should contain at least one company from a "country of operations." Trust funds may limit eligibility.
Limitations on eligibility of former Bank staff:				

*: Also applies to IFC, in addition all companies or individuals working for any part of the World Bank must have a Vendor Identification Number, which can be acquired from the World Bank's contract branch.

6.7 Competitive selection requirements for advisors

As indicated in Table 6-9, all the agencies favor competitive selection processes. They all set project sizes above which competitive selection must take place. These project sizes typically differ depending on what is to be procured (i.e. whether the contract is for technical assistance, goods or works). The numbers presented in Table 6-9 are those above which technical assistance contracts must be subject to a competitive selection process.

Table 6-9
Competitive selection requirements for advisors

World Bank (IDA/IBRD)**	IADB	AfDB	ADB	Europe (EBRD)
Sole source only for contracts below US\$100,000 or where there is a clear advantage for one particular firm (e.g. natural continuation of work currently being undertaken). Shortlisting of 3-6 firms required.	US\$200,000 requirement for public announcement of intention to contract but all contracts require shortlisting of 3-6 firms.	All contracts above UA 350,000* must be advertised and shortlist of 5-7 firms developed. Contracts of a lesser amount must still develop a similar shortlist but need not be advertised as widely (see next section).	Projects should be carried out in such a way that contracts are of type and size to allow international competitive selection but sole-sourcing allowed in exceptional (not defined) cases. No fixed size of shortlist but usually 5-7 firms.	Any contracts less than Euro 50,000 can be sole sourced. Contracts for firms between Euro 50,000 and Euro 200,000 must use shortlist but no need for firms to submit proposals. Contracts for firms in excess of Euro 200,000 require a competitive proposal based selection.

*: 1 UA = 1 Unit of Account = 1 SDR = (approx) US\$1.4

** : IFC is under no obligation to let contracts through a competitive process

6.8 Advertising and shortlisting

Each agency requires advertising in a variety of journals and newspapers in order to develop a shortlist of firms who will then compete for the contract. Typically, the agencies require that projects for which there will be a competitive selection process are advertised in the agency's specialist publication and in a national newspaper. These requirements are summarised in Table 6-10.

Table 6-10
Advertising and shortlisting requirements

World Bank (IDA/IBRD)**	IADB	AfDB	ADB	EBRD
Must advertise in Development Business and a national paper if contract will exceed US\$200,000 – may also contact firms directly. Must provide at least 30 days to respond, usually shortlist 3-6 firms.	Contracts exceeding US\$200,000 must be advertised in Development Business, and in national newspapers for expressions of interest. In addition, must inform all IADB member countries with embassies accredited in country that is undertaking the work, shortlist 3-6 firms.	Contracts above UA 350,000* must be advertised in Development Business and at least one national newspaper. Lesser contracts must be advertised in one national newspaper and a notice sent to representatives of member countries. Should shortlist not more than two firms from same country.	Advertising in ADB Business Opportunities and national newspaper. The Bank may also require advertisements in technical journals for specialized projects. Shortlist can also be drawn from Bank sources and diplomatic missions, usually 5-7 in shortlist.	Contracts in excess of Euro200,000 must be advertised in EBRD's Procurement Opportunities and a shortlist made on the basis of responses.

*: 1 UA = 1 Unit of Account = 1 SDR = (approx) US\$1.4

** : IFC is under no obligation to advertise opportunities

UN Development Business

UN Development Business provides notices for billions of dollars in exporting, contracting and consulting opportunities from official sources. It publishes notices, both in paper format and electronically, from the World Bank, IADB, AfDB, ADB, EBRD and the UN. It is published by the United Nations.

A journal is issued every 2 weeks (24 times per year) and any organization can subscribe to receive a copy (the price in 2000 varied from US\$250 to US\$695, depending on the detail and format requested).

For more information about both submitting announcements or receiving the publication see <http://www.devbusiness.com> or call the Subscriptions Department +1 212 963 1516.

6.9 Use of individuals

Each of the agencies distinguishes contracts signed with firms from those signed with individuals. Contracts signed with individuals are usually for amounts below the requirements for competitive selection, thereby simplifying the required selection process. When competitive selection is required, the requirements typically call for a comparison of the skills and experience of a shortlist of 3-4 people. This is often because individuals are hired for their specific expertise and so there are a limited number of people who could compete for the proposed contract.

Special attention must be paid to potential conflicts of interest when individuals are hired. For example, some of the qualified individuals may previously have been employed by the lending agency in question. Most of the agencies have restrictions on the use of former employees, limiting either their hiring or the amount they can earn.

Details are provided in Table 6-11.

Table 6-11
Use of individuals

World Bank (IDA/IBRD) *	IADB	AfDB	ADB	EBRD
Use individual if team not required or if specific qualifications of individual paramount. Selection based on qualifications. The Bank also has restrictions on the use of former Bank staff.	In general, contracts should be large enough to allow firms to be shortlisted and for them to bring in individuals if require specific expertise. However, will consider using individuals if specific local knowledge required.	Can be used for short term assignments (less than two months) without shortlisting. Longer assignments require shortlisting of 3-4 individuals and selection process based on CVs.	In general emphasize local firms but especially important when comes to hiring individuals that are local. For individuals also generate shortlist but do not need formal proposal ranked on basis of CV and negotiate with top ranked individual.	Use individuals where specific skills are required and amount of work does not require a firm. Must generate shortlist and evaluate individuals if contract size exceeds Euro 50,000.

*: the same restrictions apply to the IFC

6.10 Agency requirements for selection

There is a wide range of methods to evaluate proposals, although they generally amount to some combination of weights on a technical and financial evaluation. Module 7 outlines the relative merits of different forms of evaluation. In all cases when non-competitive contracts are awarded (see Section 6.1 for conditions) the primary criterion for evaluation is the qualifications of the firm or individual, with a negotiated financial arrangement. Procedures for competitive selection vary across the agencies. The main requirements are set out in Table 6-12.

A detailed discussion of how to evaluate and select consultants for advisory services is provided in Modules 7 and 8.

Table 6-12
Evaluation

World Bank (IDA/IBRD)*	IADB	AFDB	ADB	EBRD
Usually require quality and cost based bids. Separate technical and financial proposals with technical evaluated before looking at financial. Financial only opened after no objection from Bank on technical evaluation. Weighting on financial chosen by government concerned but cannot exceed 30%.	Evaluation is only quality based – no financial. Selection on basis of experience in projects of comparable size, complexity and technical speciality, competence of personnel, experience in region and elsewhere, language capability, financial capability and current work load. Financial terms negotiated with top scoring firm.	Evaluation procedure is determined by borrower subject to Bank approval. In general three types approved: based solely on technical merit, based on a weighted average of a technical and financial score and based on a technical hurdle with lowest cost of qualifying firms winning.	Usually requires both technical and financial bids but technical dominates. Borrower can select whether or not financial proposal is submitted. If financial is submitted then use a two-envelope system in which financial envelope of only top-ranked technical bid is opened and forms basis for negotiation.	Normally based solely on quality, including experience in similar assignments, experience in region, qualifications of key personnel and suitability and quality of workplan. In some assignments (usually straightforward technical ones) price can also be a criterion but always secondary to quality.

*: IFC is not under an obligation to undertake any particular form of evaluation

Useful Reading

In addition to the websites referred to in Section 6.2 which contain much of the published procurement guidelines of the donors:

IDB Basic Procurement Policies and Procedures of the IDB, 1995.

World Bank Guidelines: Procurement under IBRD Loans and IDA Credits, 1995.

Procurement Homepage International (PHI) <http://www.procurement.org/>

PHI provides world wide system of links that those considering projects and procurement officers may find useful. It contains mainly databases of government procurement agencies and private companies requesting services and goods but also summarizes some of the main procurement guidelines. It is maintained by a German based law firm and breaks links down by country of origin. Some of the pages can also be viewed in German, Spanish or French.

Annex 1: Acronyms and abbreviations of bilateral institutions

Table 1
Acronyms and abbreviations of bilateral donor organizations

Acronym	Name	Country
AFD	Agence Française de Développement	France
CIDA	Canadian International Development Association	Canada
DANIDA	Danish International Development Association	Denmark
DFID	Department for International Development	UK
GTZ	German Agency for Technical Cooperation	Germany
JBIC	Japanese Bank for International Cooperation	Japan
NORAD	Norwegian Agency for Development Cooperation	Norway
SDC	Swiss Agency for Development and Cooperation	Switzerland
SIDA	Swedish International Development Association	Sweden
USAID	United States Aid Agency	USA

Glossary

Advisor	An individual or company providing information and/or recommendations
Analysis	The production of a report or statement setting out the underlying reasons for or causes of a particular event or outcome
Bait and switch	The practice of enticing a client by promising the participation of particular individuals and, once the client is committed, switching the promised individuals for others
Billing schedule	Description of when and under what conditions invoices (bills) can be submitted
Bottom line	In financial proposals, the minimum acceptable level
Bribe	Receipt of anything, monetary or otherwise, in return for an action that would otherwise be prohibited
Chinese wall	Measures put in place to prevent the flow of specified information from one individual, or set of individuals, to another individual or set of individuals
Competition	Three main forms: in the market, the normal attempt to attract customers for your good as opposed to another similar good, for the market one off contest to provide services to a particular group, may be repeated at intervals, contestability pressure from potential new entrants. Also yardstick (or comparative) for regional monopolies imposed by only allowing tariffs based on costs of other, similar, companies (e.g., power and water distribution)
Concession	Contractual arrangement that transfers responsibility for asset management and new investment
Concessionary lending	Lending below the prevailing market interest rate for the type of loan in question
Consensus	A generally held point of view
Conflict of Interest	This arises when parties have incentives to behave in most appropriate manner do not exist because of influence from other interests or projects
Consortium	Group of companies – usually with a single lead company and others subcontracted
Consultant	See advisor

Contract	A formal, written agreement that creates legally binding or enforceable obligations on some or all the parties
Corruption	Accepting a bribe (see bribe)
Covenant	Agreement, promise or guarantee, as in a financial covenant requiring a sum of money be set aside as a guarantee for certain actions
Current cost valuation	Value of an asset based on the cost of acquiring the same asset today
Divestiture	To sell a controlling interest
Donor	Agency that lends money at a concessionary rate. Often divided into multilateral, where lending is controlled by many countries, and bilateral, where lending policy is controlled by one country.
Drawdown contract	See Indefinite quantity contract
Due diligence	Investigation and assessment of a potential project or assets
Economic value	Discounted expected net cash flow
Efficiency	Distribution of resources to their most valuable use—generally divided into three types: productive, in which a given output is produced at minimum cost given existing inputs at a point in time; allocative, in which inputs are assigned to activities where they are most useful at a point in time; and dynamic, in which inputs are assigned to their best use over time.
Evaluator	Person marking proposals, bids and other submissions
External Advisor	Advisor from outside the organization (also see Advisor)
Feather-bedding	This occurs when advisors unnecessarily expand the terms of reference
Fee rate	Charge for the time of the advisor, excluding all expenses (see also Per Diem, Reimbursable)
Financial instrument	The transfer of risk, such as long term bonds and insurance
Financial proposal	Sets out the monetary terms required to undertake a project
Fixed fee	A single fee for delivering an output that does not vary (e.g., does not change depending on time it takes to deliver the output or other costs of output)

Framework contract	See Indefinite quantity contract
Grant funds	Funds lent that have no interest payment attached to them and are not to be repaid
Greenfield project	A project built from scratch, i.e., without building on an existing or older similar project (e.g., a new water treatment plant)
Gross Domestic Product (GDP)	Total value of all output produced within a country
Historic cost	Value based on the actual cost of acquiring the existing assets
Hydroelectric	Electricity generation based on the kinetic energy of water
Implementation	Putting in place
Indefinite quantity contract (IQC)	Contract for an unspecified amount of work, usually over a few years
Industry restructuring	Altering the relationship between organizations within a sector (possibly including dividing single organizations into multiple parts)
Infrastructure	The underlying physical structure of a country, often with monopoly elements and usually involving the delivery of goods, people or information. For the purposes of this Toolkit, these include power (electricity generation, transmission and distribution, and gas distribution); sanitation (water, sewerage and solid waste services); telecommunication networks; and transportation (seaports, airports, rail, roads and bridges).
In-house expert	Expert who already works within the organization
Intellectual property	An original idea belonging to an individual or company
International competitive bidding	Selection based on a competition for which companies based outside the host country are eligible
Investor	Company or individual who invests (usually money) into a project in return for future rewards
Invitation to Tender	See Request for proposals
Knowledge transfer	Passing of information from one party to another

Lease	A contractual arrangement in which responsibility for the operation and management of an asset is conferred (see also Contract, Concession)
Letter of invitation	An introduction to an offer to submit a bid
License	A series of legal requirements that must be signed prior to being allowed to participate in a sector (see also Contract)
Loss leader	A project undertaken in the knowledge that it will make a loss, because it will establish the company or individual in the market
Lump sum	See Fixed fee
Management contract	An agreement to manage a company without assuming any responsibility for investment or asset maintenance (see also Lease, Concession)
Market value	Value of an asset, company or idea based on its sale price
Mini-proposal	A brief statement by a company or individual following a shortlisting for a project on a specific topic. May be used instead of a proposal or as a second stage to create a smaller shortlist.
Model	A representation of something on a larger scale
Modern equivalent asset value	Value of an asset based on the cost of replacing it with a modern asset that can perform the same task(s)
Multinational companies	Company with production in more than one country
Natural monopoly	Occurs when the cost of producing a given output decreases as more output is produced within a single firm; used to justify the inefficiency of competition in the market (see also Efficiency, Competition)
Objectives	Goals, aims
Per diem	A daily payment to cover expenses
Performance indicator	A test applied to determine whether expected targets have been met
Policy	A course of action adopted by a government
Pre-qualification	Creation of an initial set of requirements that must be met before a party can bid for the project in question

Private Participation in Infrastructure (PPI)	The introduction of the private sector into the provision of some aspect of infrastructure deliver or services (see Infrastructure, Service contract, management contract, Lease, Concession, Divestiture, Natural monopoly)
Private sector participation (PSP)	Introduction of the private sector to a particular area of the economy
Procurement	To obtain, acquire
Public good	Good for which the benefits of provision cannot be limited to those who pay for it and where its use does not limit the quantity or quality available to others
Regulator	Individual or agency that oversees a sector—may oversee the economic, technical and legal aspects or some subset of them
Regulatory framework	Legal and economic setting within which a regulator works
Reimbursable	Costs that the advisor can recover from the client
Remuneration	Sum of fee rate and reimbursable expenses (see Fee rate, Reimbursable)
Replacement cost	Value of an asset based on the cost of replacing it
Request for Proposals	A call to submit a proposal for a particular project
Request for tenders	See Request for proposals
Retainer	A fixed fee paid to an advisor for being available to provide advise on a specified issue over a particular period
Risk	Chance
Road show	Presentation of a project or set of assets in a number of cities around the world with the aim of raising interest of awareness of an opportunity (usually an opportunity to invest)
Select	Choose
Service contract	Contract to provide a specific service, such as infrastructure management, associated with the operation of a company
Shortlist	A list of individuals or companies allowed to bid for a project

Social goals	Goals generally associated with the distribution of wealth
Sole-sourced	Granting a project, the right to do something or a set of assets to a single party without undertaking a process by which multiple parties can bargain for the right (see International competitive bidding, competition)
Stakeholder	An individual or company with an interest in the issue
Standing charge	A tariff that is independent of the volume consumed
Stranded cost	A cost that cannot be recovered because of a change in market conditions beyond the control of the company in question
Success fee	Payment based on a percentage of the price for which assets (or the right to do something) are sold
Technical assistance	Provision of information and/or advice
Technical proposal	A document setting out the approach that would be adopted to a particular project, along with the individuals and/or companies who would carry out the approach described
Time and materials	Payment based on the amount of time taken to undertake a given task and the cost of the materials used
Track record	Past experience
Transaction cost	The cost of agreeing to undertake something
Transparent	Everyone has access to the same information about the process in question
Unanimous	Everyone in agreement
Up-front costs	Costs, usually fixed, that must be incurred prior to beginning to undertake a project or task
Utility	Company or organization that provides electrical or water services
Value for money	Creation of an outcome (an objective) at minimum cost

Toolkit:

A guide for hiring and managing advisors for private participation in infrastructure



How to select and manage PPI advisors



Table of contents

Section	Page
Acknowledgements	
7. Selecting advisors	1
7.1 The principles of the tendering process	2
7.2 Steps in the competitive bidding process	8
7.3 Advisors' proposal strategies	26
7.4 Advisors' conflicts of interest	28
8. Paying advisors for their advice	31
8.1 Fixed fee contracts	31
8.2 Time and material contracts	32
8.3 Bonus and success fees	34
8.4 Combination contracts	38
8.5 Advisors can be retained on indefinite quantity contracts	38
8.6 The phasing of payments for advisors	44
8.7 Standard contractual safeguards will be needed for advisory contracts	45
9. Managing the PPI advisory services	47
9.1 The reform process needs a structure for political management....	47
9.2 Structures for official control	50
9.3 Organizational decisions	52
9.4 Management of advisors	54
9.5 Monitoring advisors' performance	58
Annex 1: Sample Terms of Reference	61
(1) Power sector regulation	61
(2) Multimodal transport strategy	66
(3) Water regulation	71

(4) Power sector reform80
(5) Rail sector86
Annex 2: Sample Evaluation Form91
Annex 3: Format of Technical and Financial Proposals (from World Bank)111
Glossary123

7. Selecting advisors

Outline of this Module

What this Module does:

The Module presents the competitive tendering process and alternative approaches to selecting advisors. It describes the steps that need to be taken in order to implement an effective process, including how to advertise, to evaluate proposals and finalize contracts. It also describes the circumstances when other approaches may be appropriate.

Who should read this Module:

This Module should be read by officials who will be involved in, and perhaps responsible for, selecting their preferred advisors. This includes the task manager assigned to co-ordinate and manage the advisory selection process as well as any core government stakeholders who would serve on an evaluation or project management team.

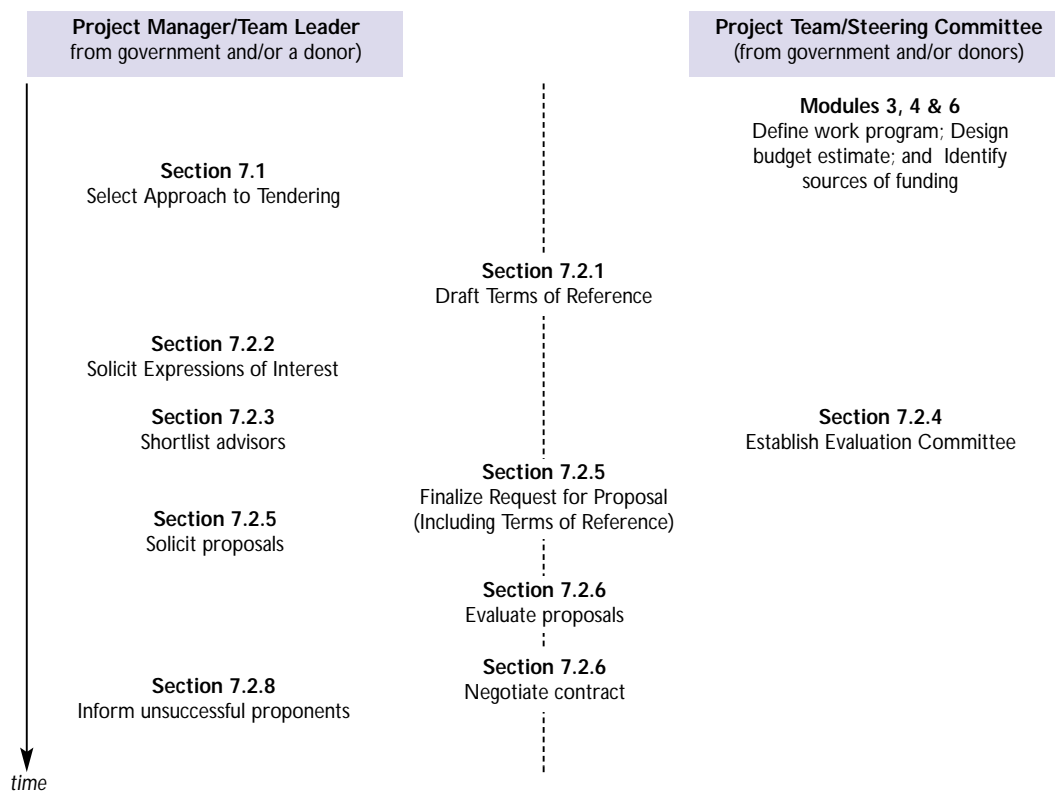
Module 4 in *Volume I* emphasized the importance of carefully defining a project prior to deciding on the form of tendering. After outlining the scope of the project, which should include a careful definition of the project objectives, four main steps were presented:

- (1) Deciding on the appropriate phasing of advice, namely when the advisors should be brought on board.
- (2) Grouping the tasks, clearly defining what the advisors should do.
- (3) Identifying the appropriate timescales, including estimated times for the advisors to complete each task.
- (4) Setting an indicative budget for the consultancy work, including the costs of the hiring process itself— indicative fee rates and costs are provided in Module 4 in *Volume I*.

Once the scope of the project has been defined, and funding sources have been identified and contacted, it is then possible to decide on the appropriate tendering process. This module focuses on the process for selecting, hiring and managing advisors.

Figure 7.1 illustrates the key steps in the competitive tendering process. On the left are those steps which are primarily the responsibility of the project manager or team leader. Tasks on the right will involve a committee or team of key stakeholders from the government and/or the donor community. Those tasks placed in the middle of the diagram are the responsibility of both the project manager and the team of official stakeholders.

Figure 7-1
Key steps in the competitive tendering process



7.1 The principles of the tendering process

The process of hiring advisors begins once the advisory work program has been defined, the budget prepared and sources of funds identified (see Modules 3, 4 and 6). Staff assigned to manage these initiatives will find that there is a variety of payment mechanisms and selection processes available from which to choose when tendering for consultants and other specialists. Most advisory assignments related to PPI require advance policy formulation and planning on the government's side. Because of the time required for these preparatory activities, officials are generally in a position to benefit from competitive tendering for advisory services, whether the advisors are expected to define the market structure for competitive service provision, develop the regulatory framework, undertake institutional strengthening and capacity building, explain policy to key stakeholders or carry out the transaction. This section describes the advantages of competitive tendering and provides alternative approaches to the competitive tendering process, focusing on different methods for selecting and grading proposals as well as optional mechanisms for contracting the advisors.

7.1.1 Competitive tendering

The decision about the manner in which advisors should be appointed is important since this process will determine whether the government receives the correct balance of quality and price. Properly designed competitive bidding processes provide the greatest chance of selecting the company that best meets the government's objectives.

Both the government and the companies incur up-front costs. The government must prepare the requests for proposals, co-ordinate the process and evaluate the submissions. The companies must spend time and effort preparing the proposal, attending any pre-bid conferences and other activities¹. Therefore, prior to deciding on a competitive process, it is important to evaluate the advantages that these costs create.

Many of the options available to governments for conducting the selection process are defined by the country's procurement and competition regulations and by procurement guidelines for consultants stipulated by the donor agencies. Usually, when donors are funding technical assistance, the competition for advisory services must be open to firms or individuals from abroad. Even if there is not a specific requirement of the PPI advisory services process, it is generally in the interest of the government to pursue as open a competition as possible.

International competitive bidding refers to any process in which more than one company from more than one country is invited to submit an offer on a particular project. It is likely, in the context of developing countries, that such competitions will involve companies from overseas because of the shortage of specialist advisors in the country where the advice is needed, and because of the importance of international experience in the PPI context.

There are a number of important reasons for using a competitive process²:

- **Transparency** A nontransparent process leads to suspicion of the parties involved and can lead to legal or other challenges that may result in slower project implementation than beginning with a competitive process.
- **Creativity** Competition can provide the government with a wide range of approaches to a particular project, revealing methods and ideas that may not have been considered and may not be developed in a sole-source context. For competitive tendering to generate this benefit it is important that companies feel confident that their ideas remain their intellectual property and that the government will not use the process to generate new ideas which subsequently are used by other advisors or internally³. It has the additional benefit of revealing the price at which advisors are willing to provide the services.
- **Confidence** Contrary to common perception, many advisors are likely to have greater confidence in a competitive process because of its transparency. Governments that repeatedly sole source projects are unlikely to attract the best advisors because they will assume that the process is fixed.

The main disadvantages of competitive tendering are the time and costs involved. However, it is often less costly and time consuming than the consequences of sole sourced projects (e.g., failure to find the best qualified company resulting in bad advice).

¹ For an overview of transactions costs for the provision of advisory services during a specific transaction, see Module 6, *The Role of Donor Agencies in PPI*.

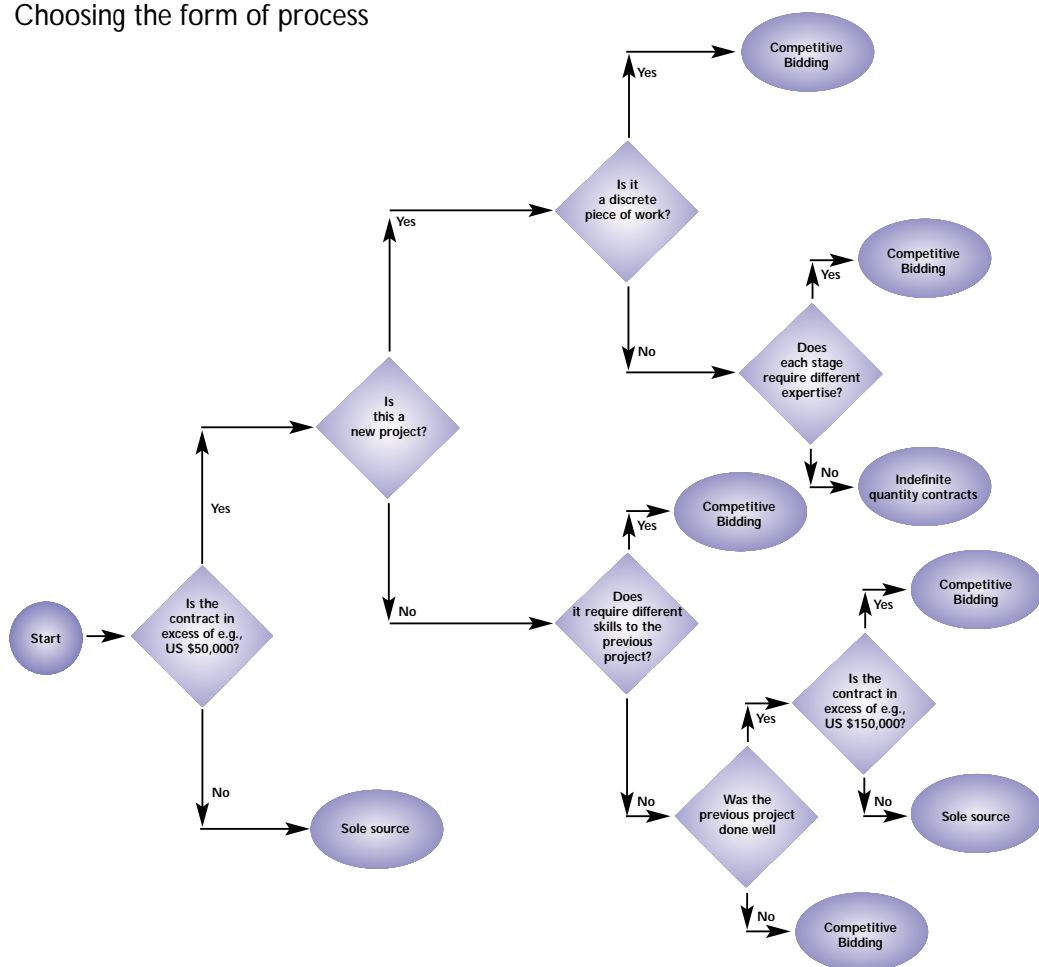
² See Trivedi, P *How to Implement Privatization Transactions*, Routledge, 2000.

³ There is an important difference between firm specific methodologies and general approaches to workplans. Governments may learn a great deal from proposals but cannot take specific ideas from proposals without hiring the advisors — firms will quickly stop bidding for projects put forward by such governments. However, governments can learn new ideas and about new publications or procedures that are not owned by any one company.

As well as taking time, the competitive bidding process also requires capable people to organize and participate in the process. Therefore it can be costly in terms of the resources used. Other costs will also be incurred – the cost of advertising, and producing and sending the relevant documentation to potential bidders.

Figure 7-2 presents the decisions required to finalize the form of award process. In deciding whether to proceed with competitive tendering, government officials will need to weigh up the advantages and disadvantages. Whatever decision is reached, it is important that officials are able to justify their decisions.

Figure 7-2
Choosing the form of process

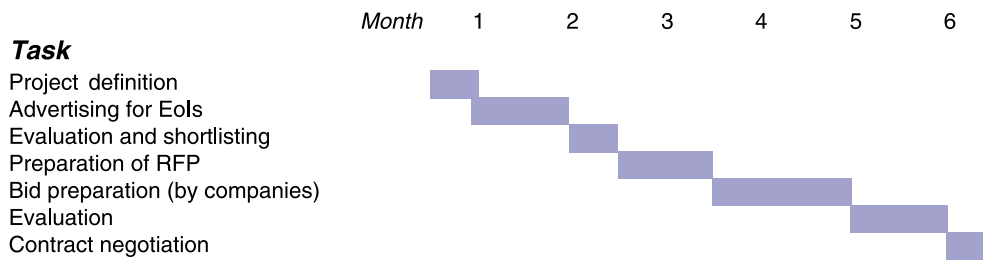


Note: dollar amounts presented in flow chart are indicative only but are based on the lowest dollar amounts acceptable among the main multilateral lending agencies (see *Volume II*).

In addition to the situations described in the figure above, governments may occasionally be faced with emergency crises related to PPI (e.g., contract negotiations following sudden devaluations, natural disasters or debilitating strikes). In these events, it may be appropriate to forego full competitive bidding procedures. Instead the government may choose to solicit proposals from a pre-formed shortlist or even to hire on a sole-source basis depending upon the nature of the crisis.

If it is decided to proceed with a competitive process then it is important to set out each stage of the process, to establish realistic deadlines and then to stick to the timetable. Figure 7-3 presents an indicative timetable.

Figure 7-3
Indicative timeline



Recommendation 7.1: Officials should favour a competitive bidding approach under most circumstances. Where competitive bidding is not used (e.g., for small projects or PPI-related emergencies), then officials should be able to justify their means of selection of advisors.

7.1.2 Approaches to proposal selection

Regardless of the proponents' nationalities, the competition may be designed in a variety of ways. The choice of selection method should be based upon the level of importance that the government wishes to assign to cost. If there is ample budget for the assignment and the terms of reference are clear, then the approaches which emphasize the firms' technical capability over low-cost proposals may be the most appropriate.

- **Technical** The final evaluation may be based solely on the technical merit of the bids based on a pre-defined marking scheme. Under fixed budget selection, companies are informed of the overall maximum budget available for the project.
- **Technical and Financial** The evaluation may be based on a weighting of the technical proposal and a price to undertake the work. (Table 7-2 outlines the differences between the different weighting schemes.)
- **Financial** The evaluation may be based solely on the final price, with the lowest price being awarded the contract.

In practice, it is difficult to penalize companies for poor performance since it is difficult to:

- define and evaluate performance criteria accurately enough – the provision of advice is an area where assessments of poor performance are very subjective;
- recover the administrative and contractual costs of firing the company and re-hiring another one, even if it is possible to penalize the company for the actual poor performance; and
- value and then prove to the satisfaction of a court the damages caused by improper advice.

Moreover, the political and social consequences of implementing a reform program based upon poor PPI advice extend far beyond the monetary value of the advisory services. Consequently, competitive bidding for advisory services is rarely based purely on price. Instead some combination of technical and financial bids are required. There are several possibilities:

- **Quality based selection** Evaluation based purely on a technical proposal followed by a negotiated financial contract.
- **Fixed budget selection** Evaluation based purely on a technical proposal followed by a negotiated financial contract based on an initial sealed financial proposal.
- **Least cost selection with technical hurdle** Final evaluation based solely on the financial bids for all companies that cross an initial technical threshold, such as 70 out of 100 points.
- **Quality and cost-based selection or weighted technical and financial selection** Final evaluation based on a weighted average of a technical score and a price bid, such as 80:20 or 90:10 depending on the importance attached to the financial component. This approach is often combined with the minimum technical threshold used in least cost selection.

Table 7-1 outlines the potential benefits and constraints associated with each approach. In practice, the approach to selecting an advisory firm or consortium will be determined by the type of work required, budgetary constraints, confidence levels in the available advisors and the procurement requirement of the funding agencies. Consequently, there is no single form of evaluation that is appropriate for all occasions. Instead, the method of selection depends on the requirements and characteristics of the project in question.

Table 7-1

Benefits and constraints of different approaches to evaluating proposals

	Benefits	Constraints
Quality-based selection	<p>Provides high likelihood that the highest quality proposal will be selected</p> <p>Provides incentives for potential contractors to be innovative</p>	<p>Provides few incentives for potential contractors to reduce costs and no basis for the comparison of prices among companies</p>
Fixed budget selection	<p>Ensures the highest quality proposal will be selected and provides incentives for potential contractors to be innovative</p> <p>May provide some opportunity for government officials to negotiate costs down</p>	<p>Limited incentives for potential contractors to reduce costs, so likely to be costly</p> <p>Difficult to back out of selection</p>
Least-cost selection with technical hurdle	<p>Provides incentives for contractors to lower costs and be innovative</p> <p>Minimum technical hurdle encourages firms to offer better quality technical proposals</p>	<p>If the technical hurdle is not set properly and the evaluation is not stringent then risk selecting a low price, low quality firm or consortium</p>
Quality and cost-based selection or weighted technical and financial selection	<p>Provides an opportunity for officials to signal their preferred trade off between cost and quality</p>	<p>Unlikely to result in lowest cost bid emerging as winner, although it should result in the best value bid winning</p>
Least cost selection	<p>In theory provides incentives for companies to bid for the true value of the contract</p> <p>Evaluation is straightforward and rapid</p>	<p>Advisors do not commit to providing specific resources or reveal staffing or project management and approach to implementation.</p> <p>High quality firms are unlikely to submit proposals</p>

Recommendation 7.2: The choice of selection method should be based upon the level of importance that the government wishes to assign to cost. If there is ample budget for the assignment and the TOR are clear, then approaches which emphasize the firms' technical capability over low-cost proposals may be the most appropriate.

When deciding whether sole-sourcing is an appropriate way forward, government officials will need to balance the costs and benefits of doing so on a case-by-case basis.

Advantages and disadvantages of sole-sourcing

Advantages	Disadvantages
Sole-sourcing is cheaper than competitive tendering	Sole-sourced projects do not provide the government with an opportunity to evaluate the technical or financial merits of alternative bids and leave the government open to criticisms of non-transparency and prone to costly mistakes.
Sole-sourcing provides a good way of securing advice quickly – this can be particularly relevant when advice requiring a particular skill or expertise (such as Geographical Information Systems modelling) is required and there is insufficient time available for other companies to acquire that expertise	Sole-sourced projects are nontransparent, creating scope for corruption or the perception of corruption.
Sole-sourcing can be an appropriate option when there are relatively few firms operating in the market and their track-records are well known	Sole-sourcing opens up the possibility of the government being open to court challenges, opposition from other politicians and the public and demonstrations, all of which will delay the project and increase its cost.

7.2 Steps in the competitive bidding process

This section outlines the key steps and documents that make up the competitive bidding process as outlined in Figure 7-1. It assumes that the officials involved will decide upon the approach to the selection of advisors before beginning with the next set of tasks.

7.2.1 Drafting the Terms of Reference (TOR)

A clear set of TOR is crucial to ensure that the potential advisors fully appreciate the aims and objectives of the government and how their support would fit into the overall process of reform. However, an overly prescriptive TOR runs the risk of stifling innovative ideas that advisors might be able to bring to the work plan.

One issue that will need to be considered is the level of detail of the TOR. As discussed in Module 4, the TOR must reflect the budget for the work. But even for a given scope of work, it is possible to vary the degree of detail included in the TOR.

While the level of detail in the TOR may vary according to the needs and status of the PPI initiative, the following information should be provided in the document:

- Background information (including information about the origins of the funds for technical assistance; the political environment; state of the economy and sector in question and major indicators; sectoral reform process and major indicators; existing legal and regulatory framework; and condition of the enterprise undergoing PPI).
- Indicative work plan (including description of the tasks to be undertaken; the expected milestones related to deliverables and government decisions; gantt charts providing an indicative schedule).

- Deliverables/outputs required (including presentations, models, reports, training and even availability for negotiation).
- Level of effort (by key personnel and major task) and/or the maximum budget available (depending upon the approach to selection).
- Evaluation criteria (including weights for technical and financial proposals; level of technical threshold to advance, if relevant; and the sub-criteria for technical evaluation – discussed below).
- Conditions for submission (number of copies, separation of envelopes, time and day of delivery deadline).

The draft version of the TOR should be provided to all other members of the Project Team or Evaluation Committee, and other relevant stakeholders. They should be given sufficient time to review the document and comment on it. Those comments will be incorporated and the final version of the TOR will be disseminated to the shortlisted firms as part of the full Request for Proposals (as described in section 7.2.7).

Recommendation 7.3: Points should be given for creativity that results in meeting the requirements of the TOR in a more logical, more complete or more effective manner. Lead advisors, if available, should be able to assist in the drafting. Examples of TOR are presented in Annex 1.

Technical proposals

Although potential bidders are usually shortlisted on the basis of their technical capability, it is normal practice for bidders to be asked to provide proof of their technical capability in much greater detail.

The purpose of the technical bid is to provide potential bidders with an opportunity to demonstrate their suitability for undertaking the work. It also provides an opportunity to suggest changes or alterations to the TOR that the bidder believes are worthwhile and scope to prove that the issues raised have been thought about and the method to finding a solution decided upon. Technical bids will usually comprise the following components:

- comments on the TOR;
- a methodology describing the approach to the project;
- information about the company proposing to provide the advice and relevant company experience;
- the proposed team to work on the project – their experience, individuals' roles within the team and the time that each will devote to the project; and
- a work or management plan.

Financial proposals

The financial or cost proposal will typically contain a detailed breakdown of the cost of the advisory services. This would cover:

- the daily rates of each team member;
- the time inputs for each team member; and
- a breakdown of reimbursable expenses (e.g., travel costs, hotel costs, meals).

The total cost must be clearly stated. Depending on the form of proposal, other information to be included may cover:

- success fees;
- costs of producing training or other manuals; and
- communications costs.

The financial proposal should also state whether the overall bid is inclusive or exclusive of tax, in accordance with the letter of invitation (see Section 7.2.5).

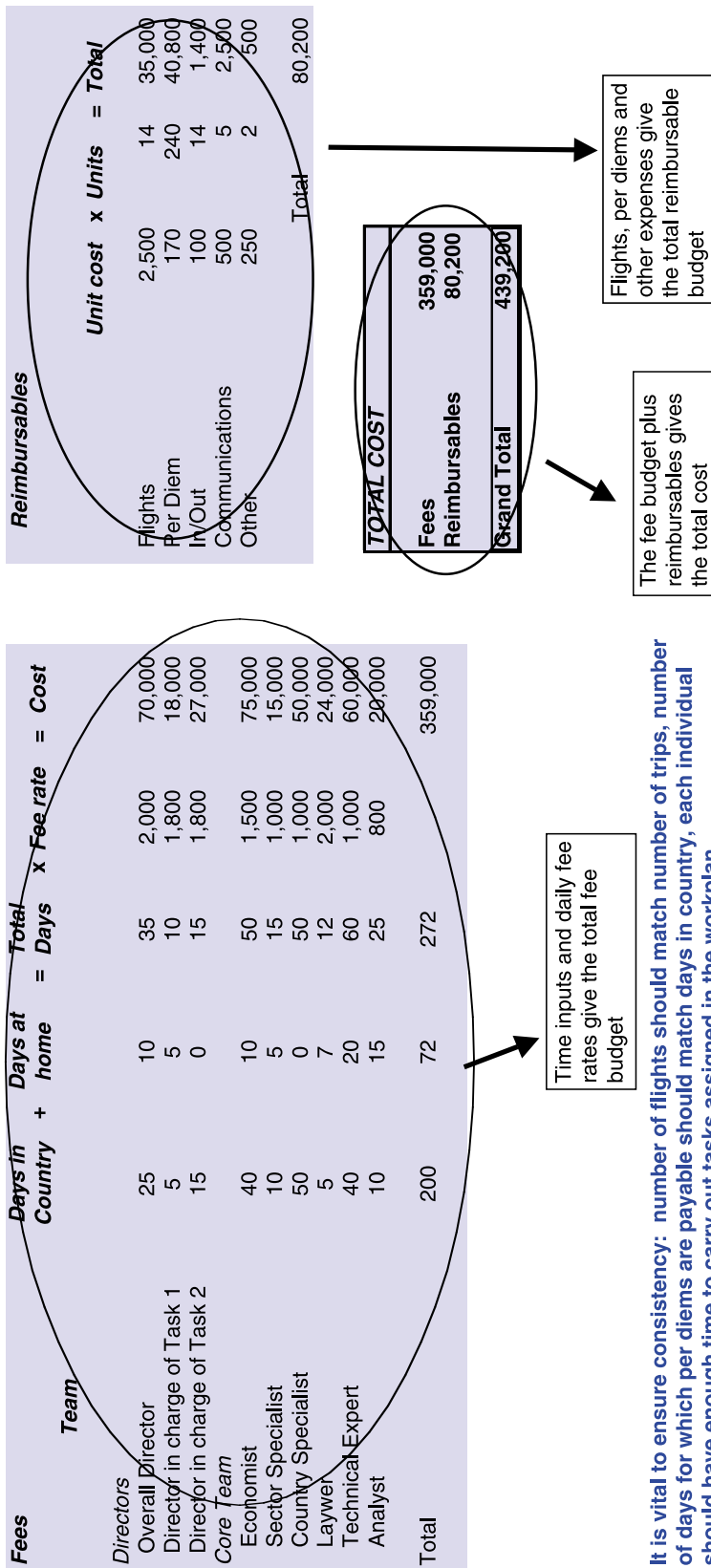
Figure 7-4 provides an indication of the way in which advisory service companies will build up their budgets for a project—analogueous to the way in which the government should build up its budget for a particular project (see Modules 2 and 4).

Combining technical and financial criteria

Section 7.1 outlined the reasons for including both technical and financial criteria in awarding the bid. If a weighting system is selected, a decision must be taken on the appropriate weights. Most weight is usually placed on the technical proposal. Typically, out of a total score of 100, 70 to 90 points will be allocated to the technical proposal with the remainder for the financial.

Figure 7-4

Example budget (numbers only illustrative—see Module 4 for indicative numbers)



It is vital to ensure consistency: number of flights should match number of trips, number of days for which per diems are payable should match days in country, each individual should have enough time to carry out tasks assigned in the workplan

7.2.2 Shortlisting advisors

The purpose of the pre-qualification of prospective advisors is to minimize the cost to the government of evaluating proposals and to provide companies with an incentive to prepare proposals. The absence of a shortlist, which would indicate a large number of proponents, reduces the chance of winning and may deter the best candidates from preparing proposals. In certain circumstances, it may be that pre-qualification is not required – for example, if there is a small number of potential bidders for the contract all of which have a strong track record in undertaking work in the area concerned.

There are three main steps to a standard pre-qualification process. However, as discussed below, in some instances some steps may be omitted:

- advertise the opportunity;
- short-list on the basis of expressions of interest; and
- inform short-listed companies.

Companies should be required to provide a brief summary of their technical abilities and brief details of senior staff who would be available for the project. Given the large number of such submissions the advertisement (discussed below) should stress the importance of brevity, perhaps indicating a maximum page length (e.g., 20 pages).

There is a wide range of criteria that could be used to determine whether companies or individuals ought to go forward to the short-listing stage. However, the most important criteria at this stage is the technical capability of the company and individuals. This may include relevant experience, both at a company level and for individuals, and also ideas about how best to approach the project.

When considering the issue of qualifications at this stage, it is important to look at both the company experience and that of any named individuals. Given the diverse range of considerations, it will also be worthwhile considering whether individuals and companies have the relevant sector and regional experience. This will be particularly important when assessing technical experience.

As a general rule, the approach adopted to determining the short list ought to reflect the size and level of the transaction. Typically it will be sufficient to evaluate those who express interest on the basis of their written submissions. As indicated in *Volume II*, shortlists usually range from 3 to 7 companies, with most shortlists consisting of 4 or 5 companies.

Alternatively, informal screening over the telephone might also offer a less time consuming option for identifying potential companies that might feature on the short list, particularly for small contracts. If appropriate (for example, if local advisors are being used), government officials could meet with potential advisors. This will provide an opportunity to assess whether advisors should be short-listed and for potential companies to acquire information about whether they ought to invest time and effort in preparing a proposal. However, both of these should be undertaken with great caution because they may be perceived as non-transparent. If they are undertaken, there should be a full reporting of the meeting.

Finally, officials may take up references, in writing, in person or over the telephone, to find out whether a company or individual is sufficiently qualified to be placed on the short list.

Shortlisted companies should be contacted, either in person or by post, email or fax, to let them know they have been shortlisted. At the same time they should be given the full bidding documents, also known as the Request for Proposals.

Recommendation 7.4: Officials will need to decide on the appropriate number of advisors to be included on the shortlist – this will depend upon their capacity to handle proposals, the size and nature of the technical assistance required and the importance of the specific PPI project. In any case, the shortlist should not be less than 3 companies, nor more than 7.

7.2.3 Soliciting Expressions of Interest

For all but relatively small, emergency or highly specialist projects (for which all the relevant companies can be contacted), it is wise to advertise for advisory services in one or two prominent publications. This helps to:

- ensure that the process is transparent; and
- increases the field of potential proponents.

Otherwise the only companies to hear about the projects are likely to be those with contacts close to the contracting agency.

Furthermore, many donor agencies who are providing the funding for the technical assistance may have procurement procedures that must be followed (see *Volume II*) with regard to public announcements. Similarly, the officials' own governments may have procurement guidelines that require advertising. If so, officials have no choice about whether to advertise.

If a decision not to advertise is taken, officials will need to identify potential advisors from other sources. Lead advisors may be able to suggest potential specialist advisors who might be appropriate for the short list. Donor agencies may also be of assistance.

Issues in finding work: local contacts

International advisory firms sometimes commission local companies, or specialist agencies, to look out for upcoming work and put their name forward for any potential shortlistings in their area of expertise. These local companies are then paid a commission for every shortlisting they manage to achieve and receive a further commission if the project is won.

While this is a good way for international companies to ensure that upcoming projects are brought to their attention, there is a danger that the resulting shortlist is composed simply of companies with the best local contacts rather than those best able to carry out the work. In recognition of this, some donor agencies have strict guidelines about the use of local companies and the payment of such commissions. In particular, the company must declare in its proposal the amount that has been or will be paid in the form of a commission. This also argues strongly in favor of advertising upcoming projects outside the country in which they will take place—each of the multilateral agencies has specialist publications in which they advertise upcoming projects (see *Volume II*).

Frequently used outlets for advertising include:

- local newspapers;
- government websites;
- donor agency websites; and
- donor agency procurement publications such as UN's "Development Business"(see *Volume II* for details).

Figure 7-5 provides an example of a typical call for expressions of interest for a hypothetical country and funding agency.

Figure 7.5

Example of a request for an expression of interest

Country: Robinsonia

Project: REGULATION IN THE WATER SUPPLY AND WASTEWATER SECTOR

Sector: Consultants

Product: CONSULTANT SERVICES

The Government of Robinsonia has received a grant from the Council for the Development of Island Economies (CDIE), and intends to apply part of the proceeds of this grant to payments under the contract for Robinsonia-Technical Assistance for the Regulation Of the Water Supply and Wastewater Sector. The CDIE is a multi-donor technical assistance facility aimed at helping island countries improve the quality of their infrastructure through private sector involvement.

The services required comprise four areas: (i) review of existing legal framework; (ii) analysis and proposal for quality regulation; (iii) analysis and proposal for economic regulation; and (iv) a proposal for the creation, staffing, and funding of the regulator. The consultant's final report will outline a clear proposal to develop the regulatory framework and to create a regulator. The report will propose specific modifications of existing laws, development of new legislation, the details for the establishment and operation of the regulating body. The report will be used by the Robinsonian law makers to draft necessary amendments and regulations. The implementation period is approximately 22 weeks. The cost cannot exceed US\$ 500,000.

The CDIE now invites eligible consultants to indicate their interest in providing the services. Interested consultants must provide information indicating that they are qualified to perform the services (brochures, description of similar assignments, curriculum vitae of available staff, and experience in similar conditions). Consultants may associate to enhance their qualifications. A consultant will be selected in accordance with the procedures set out in the World Bank's Guidelines: Selection and Employment of Consultants by World Bank Borrowers, January 1997 (revised September 1999).

Interested consultants may obtain further information at the first address below. Expressions of interest must be delivered to the second address below by 15:00 hours, 30 October 2000.

For Information:

Government of Robinsonia
Cabinet Committee on Sectoral Reform
Watertown, West Island
Robinsonia
Facsimile: 83(8)-141-00

Submit to:

CDIE
PO Box 12
Geneva.
Switzerland
Att: Robinsonia Water Regulation Project

7.2.4 The evaluation committee

The evaluation process is likely to be based on a selection panel evaluating the proposals against pre-agreed criteria. It will be necessary for the selection panel to meet in advance of receiving the proposals to agree the criteria on which the proposals will be judged, how they will be applied and the basis on which decisions are to be reached. The panel must agree on the marking scheme – see the discussion below.

Several factors should be examined in determining the composition of the evaluation committee:

- (1) Size
- (2) Competence
- (3) Transparency
- (4) Acceptability

Evaluation and Selection Committee

In some donor agencies, evaluation and selection committees perform distinct tasks. The evaluation committee, usually composed of three people one of whom will eventually manage the project (the task manager), undertakes the initial scoring of the proposals and puts forward their recommendation to the selection committee. The selection committee, usually composed of the immediate superior of the task manager, someone from the procurement division and a member of the in-country office, then verifies that appropriate procedures were followed and approves or rejects the recommended proposal.

Size of the committee

The evaluation committee should not be so large so that it becomes unwieldy. To the extent that the size and complexity of the assignment require greater expertise on the committee, the size of the committee will vary. While using a single individual would probably be faster than a multi-person committee, the process may be viewed as less transparent and it may be difficult to ensure that a single individual has all of the required skills. Balancing these requirements would suggest an evaluation committee ranging in size from two to five people, depending on the requirements of the project in question. Larger, more complex or more politically sensitive projects require larger evaluation committees.

Skills of the committee

It is important to have people on the committee who are able to assess the technical, financial, legal and economic areas being considered. For example, for a project leading to the introduction of PPI in roads, when appointing technical advisors, it would be desirable to have transport department engineers on the evaluation panel who will be able to appraise the technical merit of the proposals. Similarly, economists and legal specialists may be required to participate in the evaluation committee.

Under this approach, each expert evaluates different sections of the proposals and the scores are added to form an aggregate score. An alternative approach is for each individual to come up with an aggregate score themselves—marking both the section in which they have expertise and those in which they have less knowledge. A well written proposal should be understandable by intelligent committee members who are not experts in every aspect of the project. If the latter approach is adopted then

it may be worthwhile having the experts present their views on particular sectors to the evaluation committee, who can then decide on how to score the proposals themselves.

Transparency of the committee's approach

In order to maintain integrity in the procurement process in general, it is vital that the evaluation is itself transparent. Part of this, discussed above, is the inclusion of the marking scheme in the request for proposals. Another component is ensuring that the basis for the evaluation (e.g., relative or absolute grading) is clearly understood. The final components include ensuring that:

- all committee members evaluate the proposals independently;
- if there is general discussion to reach a final decision, then minutes are taken at the meeting by an independent party (i.e. someone other than a committee member); and
- those who lose receive a clear explanation of why they were not successful if it is requested⁴.

The final element is also important in ensuring that losing companies or consortia will be willing to submit bids for future projects in similar areas.

Stakeholder acceptability

A large part of ensuring acceptability is ensuring transparency. However, another component is to ensure that the stakeholders who will be affected by the results of the study are involved in the process of selecting the advisors. This may be accomplished by including some or all of the stakeholders on the evaluation committee, depending on the number of stakeholders. An alternative may be to ask the stakeholders to nominate someone who they would all like to see as part of the evaluation, for example a non-governmental organization working in the area.

Ensuring acceptability

A private utility in Africa hiring advisors to help them during a tariff review decided to try to ensure acceptability by allowing the regulator to play a role in the evaluation process. The company first shortlisted four advisory companies and evaluated their proposals. It then submitted its two preferred companies to the regulator and allowed the regulator to select the winning firm. This ensured that both parties had a role in selecting the firm—trying to ensure that the company was satisfied with its advisors while the regulator was also bought into the process and felt comfortable working with the selected firm.

Recommendation 7.5: The evaluation committee should reflect the appropriate mix of specialist skills and key stakeholders – but at the same time the committee should not be so large that it is difficult for it to reach a decision.

⁴ This raises the question of whether these explanations should also be given at the shortlisting stage to companies not shortlisted. This may create a lot of work because many companies will often submit expressions of interest. Therefore, in general, unless a specific request is sought, explanations need not be given at the shortlisting stage.

7.2.5 Finalizing the Request for Proposals

Once the shortlist of potential advisors has been drawn up, requests for proposals (sometimes referred to as the RFP or the Invitation to Tender, ITT) should be sent out to the shortlisted companies. The request for proposals should include:

- (i) a letter of invitation;
- (ii) the terms of reference (ToR); and
- (iii) a draft contract.

Some donor agencies and governments separate the information differently and add a separate background section on the project, or a “data sheet” which provides details about the selection criteria and proposal logistics. Alternatively, this information can be included in the letter of invitation or TOR itself.

7.2.5.1 Letter of invitation

A letter of invitation should accompany the packet of material in the RFP. The letter normally includes:

- the deadlines for receiving proposals;
- the way in which they should be sent;
- format of the proposal (e.g., written, oral presentation);
- details of the evaluation process, with a listing of the evaluation criteria and description of how they will be used;
- the timetable for making decisions;
- the name and contact details of the person to whom any questions about the request for proposals should be addressed (along with a statement indicating that any questions, and the answers, will be copied to all the shortlisted companies and a deadline for the submission of any questions);
- whether or not teaming up with other shortlisted companies is required;
- whether it is possible to bid for parts of the project or only the project in its entirety;
- request for response on intention to bid;
- any relevant financial information (e.g., whether the costs of preparing the proposal are reimbursable, whether the financial proposal should include local taxes); and
- a list of the other companies that have been invited to bid.

Some of these issues require further comment.

Forming consortia

The letter should specify whether companies on the shortlist will be allowed to form consortia and submit proposals together. The advantage of allowing companies to do this is that the request for proposals provides much more detail about the project than the initial advertisement. Upon seeing the full TOR, companies may discover that they are only able to cover all the issues to the required standard by forming teams with other firms or individuals. However, allowing shortlisted companies to form consortia among themselves rapidly decreases the size of the shortlist and reduces competition. A typical shortlist of 5-6 companies only requires two or three companies to form a team before the competitive element is endangered.

Consequently, forming teams among the shortlisted companies is often prohibited but shortlisted companies are allowed to create consortia using companies that have not been shortlisted. The firm that was originally placed on the shortlist should serve as the lead firm in the newly formed consortia.

Recommendation 7.6: Companies should be encouraged to form consortia in order to ensure that they can provide the full range of skills required by the project. Companies on the shortlist should generally not be allowed to form partnerships among themselves because of the risk of decreasing competition.

Task coverage

Companies should be instructed about whether their proposal must cover the entire request for proposals or whether they can bid for the parts of it in which they specialize. While the latter may allow the government to select the best firm for each particular task, it exposes the government to a number of risks: some tasks may not receive any bidders⁵ and project management rests with the government (unless this is bid out as a separate task—see Module 3 in *Volume I*). Given these risks, in general the government should carefully consider a project once it is defined. If it contains relatively large, discrete components then the government can consider undertaking a different competitive tender for each component. Alternatively, if the components are inter-related then a single tender that explicitly instructs companies to form consortia is likely to be the best approach, provided the linkages do not lend themselves to conflicts of interest (e.g., regulatory design and transaction advice – see section 7.3.3).

Proposal format

Most proposals continue to be submitted in written form, however interviews and formal presentations might, under certain circumstances, be considered as an addition.

The advantages of a presentation are that the evaluation committee can ask detailed and clarifying questions and can get a better idea about the people that they would be hiring.

Intention to bid

Finally, the letter of invitation may also require that companies confirm whether or not they intend to bid. This allows the government to keep track of the companies which will be proposing, to ensure that sufficient proposals will be received to make the process competitive and conform with requirements of procurement guidelines (see *Volume II*).

Firms are generally provided with one or two weeks to respond with a confirmation letter regarding their intention to bid.

⁵ This could easily happen for a standard shortlist of 5-6 companies covering a relatively large advisory program.

Once shortlisted, companies may decide not to submit a proposal. There is a wide range of reasons why companies who submit expressions of interest may, when shortlisted, decide not to propose:

- upon learning more details in the full TOR they may decide they are no longer technically suited for the project;
- staff may be occupied on other projects and unavailable should they win;
- the firm may fear that a particular competitor has a strong advantage;
- the indicative budget is viewed as too low;
- the probability of winning may appear too low when the number and quality of competitors is weighed against the cost of preparing the proposal; and
- project may no longer fit within the broader strategy of the company.

The competitive nature of the process will be endangered if too many companies decide not to submit a proposal. It is usually not advisable to add a new company to the shortlist if one of the shortlisted companies drops out. First, the original shortlist was made up of the best companies therefore the new company is, by definition, inferior. Second, the new company will have less time to prepare its proposal. For these two reasons, the new company is unlikely to be seen as a genuine challenge to other companies and so does not enhance the competition. Consequently it is important to try and prevent companies from dropping out once they have been shortlisted. In order to minimize this risk, it is important that:

- the budget reflects the quantity of work which is detailed in the TOR;
- the TOR contain no major surprises (i.e. they follow logically from the call for expressions of interest to which the short listed companies originally responded);
- the shortlist does not contain a mix of firms that may frighten away one or more bidders⁶;and
- companies respond to the letter of invitation to confirm whether they will proceed and submit a proposal.

It is theoretically possible to impose financial penalties for non-submission of proposals by forcing shortlisted companies to submit a bid bond within a few days of receipt of the TOR. This bond is a sum of money deposited with the agency running the selection process and returned (along with any accrued interest) to the companies once proposals are received.

7.2.5.2 Background information

The background information should cover general information about the context in which the PPI initiative is being undertaken, including:

- the political and historical context;
- sector background to the project and the aims of the reform;
- role of the procuring government department and its relationship with other bodies relevant to the project;
- importance and relevance of the project to the government; and
- description of existing service provision and why it is being updated, replaced or reformed.

⁶ For example, a shortlist for PPI work which contains two large international firms and three local firms and which is heavily weighted toward the financial proposal may result in a no-bid decision from the international firms since they know that their costs will be much higher than the local firms. Conversely, if the selection criteria are heavily weighted toward firm experience, the local firms may choose not to compete, especially if they are unable to locate an international partner to join them.

The TOR may also contain a list of background documents that companies can consult for further details and contact details for members of government who may be available to answer questions about the sector in question⁷.

7.2.5.3 Finalizing the Terms of Reference

At this stage, the TOR should be finalized incorporating suggestions from the Evaluation Committee (which may be the same as the Project Committee). In particular, the project manager should be careful to make sure there is consensus on the suggested workplan and on the evaluation criteria since the same individuals reviewing the TOR are likely to share responsibility for evaluating proposals.

7.2.5.4 Draft contract

This should cover the terms and conditions of employment of the winning company or consortium. Depending upon government procurement regulations and the reliance on donor funds, there may be a standard contract that must be used.

Otherwise, key elements that the contract ought to contain include:

- A contract number and model title page, explaining the submission and signature obligations of both parties;
- The Term or duration of the contract;
- Description of the role of related documents spelling out the scope of work (typically the final proposal, attached as an Annex);
- Provisions for modifications to the scope of work;
- Responsibility for contract administration and project management (both substantive review/management and handling of invoices) on the government or donor's side;
- Responsibility for project management on the contractor's side, and definition of specific task responsibilities;
- Definitions of Conflicts of Interest, including such sub-items as: definition of inappropriate commissions or discounts; requirements to abide by procurement rules of donors or government agencies; moratorium on related project work, defining the term of the moratorium and the conditions; definitions of conflicting assignments; and warnings about bribery of officials or related stakeholders.
- Confidentiality requirements;
- Provisions for changes or modifications to the contract itself;
- Rights to audit related documents and financial statements of advisory service provider;
- Penalties and conditions for reimbursement in the case of non-performance;
- Rights or restrictions for the assignment of contractual obligations to third parties, including sub-contracts or informal arrangements;
- Ownership of property used by contractor during the course of the project;
- In the case of donors, the use of the institutions name or logo;
- Insurance requirements with specified levels of coverage;
- Indemnification of the client;
- Exemption of liability from consequential damages;

⁷ If the latter is included it is important to emphasize both to the proponents and the officials in question that they should only provide background information (e.g., current state of the sector in question, current legislation pertaining to the sector) and not information about the bidding process itself. Any questions about the bidding process should be addressed to the issuing department, as outlined in the letter of invitation (see Section 7.2.5).

- Dispute resolution, including the use of local, foreign or UNCITRAL rules for arbitration;
- Definitions of Force Majeure, and detailed descriptions of compensatory measures to be taken in the case of Force Majeure;
- Conditions for Termination for Convenience, including notification period;
- Conditions for Termination for Default on commitment to perform specific services with explicit resources. This clause may include definitions of "corrupt" or "fraudulent" practices that would lead to a Termination for Default;
- Contract price and payment schedule detailing all milestones as negotiated in the final proposal. This should include documentation requirements and obligations of the client to approve and deliver payments;
- Copyright as it pertains to the deliverables resulting from the contract;
- Limitation on the contractor to make reps and warrants against the client;
- Requirements for the contractor to provide notification to the client; and
- Designation of appropriate signatures and signature page.

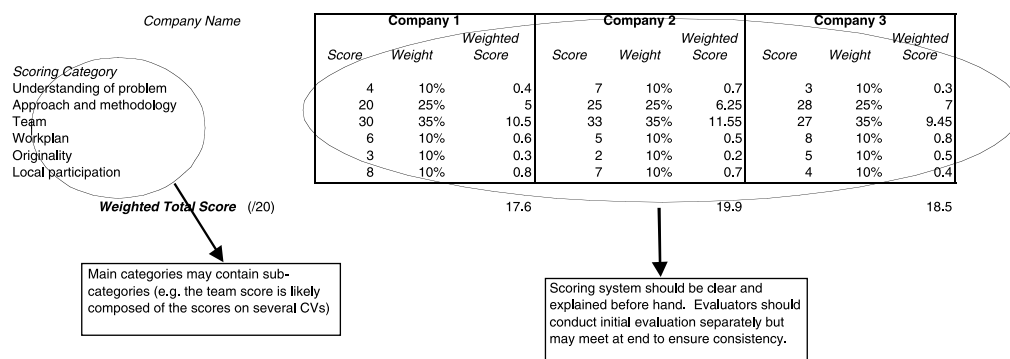
Including a contract allows companies to understand the terms and conditions under which they will be required to operate. It may also shorten the negotiation process with the top ranking company by informing bidders that, unless they object to particular clauses in their proposal, they will be deemed to have accepted the outline contract. The main disadvantage of this approach is that it will force all the companies to spend time reading and outlining their objections to the contract, rather than writing other parts of the proposal. The contract should clearly spell out the nature of conflicts of interest and the penalties (usually disqualification) for companies that are in conflict (see Module 4, *Volume I*, for more detail on conflicts of interest).

Recommendation 7.7: Officials should ensure that the request for proposals documentation is both clearly written and specific in terms of the outputs required. At a minimum it must contain a letter of introduction and a clear TOR.

7.2.6 Evaluating the proposals

Figure 7-6 provides an illustration of a scoring sheet given to evaluators of a bid.

Figure 7-6
Illustrative scoring sheet



Once the panel of selectors has read through and considered the proposals and graded them independently, a second meeting may be arranged in which each of the proposals are discussed in a systematic way. Depending on the complexity of the proposals, written reports evaluating the proposals might be prepared by the relevant specialists.

It will be important for those evaluating the proposals to recognize a number of trade-offs:

- There will often be a trade-off between the level of experience of individuals and the amount of time that they will have available to devote to providing advice. More experienced individuals will tend to be more in demand, and hence will be less involved in the day-to-day aspects of providing advice. In addition, as discussed in Module 4 of *Volume I*, more experienced individuals will be more expensive. Therefore, it is important to recognize that it is not necessary for all work to be undertaken by the most senior members of the team. More junior members are likely to be equally capable of doing some parts of the work and less expensive.
- The technical proposal should describe how the problems will be tackled but should not be expected to provide a solution.
- Larger teams provide scope for greater expertise but are also more difficult to manage.
- A single company offering to cover all the requirements may find management easier but is unlikely to have the best experts in each area (for a more detailed discussion of the formation of consortia see Module 4).
- Longer proposals may contain more detail but not necessarily better ideas.

Of utmost importance to a successful appointment process is transparency in the evaluation process. There are a number of key elements in an evaluation process.

- **Public opening of the advisors' proposals** A public opening, especially of the financial bids, reduces the potential for fixing the result. A second motivation is that a public opening of the advisors' bids presents a useful public relations opportunity for the government, allowing it to publicise the project in question. If companies are invited to attend public openings they should be given at least 2 weeks warning and the person named as being in charge of the overall project should be invited. They may subsequently delegate another person—either from the same company or another company—to attend. Companies should not be penalised for not attending the public opening of documents.
- **Evaluation criteria** Details of these should be included in the request for proposals. Such an approach was described in the earlier sections. The main advantage of adopting this approach is that it is open and therefore less prone to challenge. It will also make the process of debriefing unsuccessful bidders more straightforward (see Section 7.2.8).
- **Independent justifiable scoring** It is important to ensure that officials marking the technical proposals are able to justify the scores they attribute to each bidder and mark the proposals independently.

A transparent method of evaluating technical and financial proposals is illustrated below.

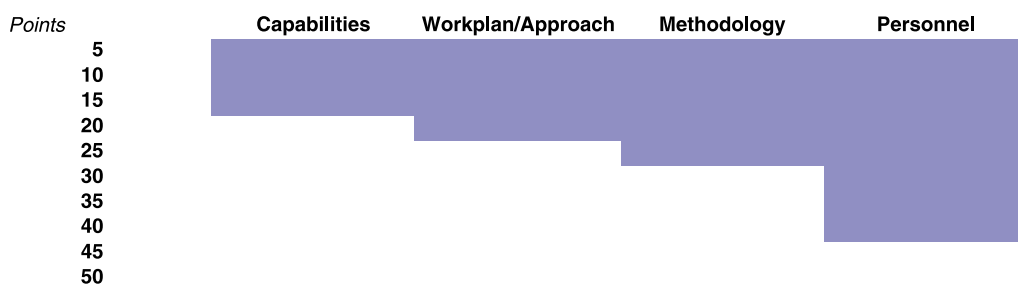
The range of factors (together with an indicative scoring system) which the selection panel might consider when assessing different technical proposals include the following (numbers in brackets provide only indicative measures):

- Overall company capabilities (10-15 points)⁸.
- The quality of the proposed work plan and approach to project management (10-20 points).
- Quality and innovativeness of the methodology (10-25 points).
- The numbers, qualifications and competence of the personnel proposed for the assignment (30-50 points), broken-down into:
 - general qualifications (6-8 points)
 - adequacy for the assignment including experience in the required areas of expertise, and working as part of a similar team (10-15 points); and
 - relevant country or regional experience (14-17 points).

Figure 7-7 illustrates the relative weighting of the different categories.

Figure 7-7

Weighting of categories



Before the request for proposals is issued, it is crucial that a scoring system is agreed which reflects the relative importance of each of the individual criteria and that it is clearly presented to all the bidders in the request for proposals.

Of critical importance is the approach to marking the bidders. There are two potential approaches and it must be agreed at the outset which will be used.

- (1) **Relative scoring** Companies are given scores depending on the relative rankings—for example, in the case of 3 companies bidding for a project, the best company would receive 9/10 in a particular category, the next best 8/10 and the final company a 7/10.
- (2) **Absolute scoring** Companies are given scores based on an assessment of the quality of the proposal itself, in this case the best company may only score 6/10 in a given category but everyone else happens to be worse.

⁸ Relatively few points are given for this category because companies were initially shortlisted based on their overall capabilities.

Evaluators must be clear which system is being used because otherwise it is not possible to reach a consistent decision. An important disadvantage of the relative scoring system is that it is not possible to derive a meaningful average score from the scores of the individual evaluators— i.e. it is not possible to add up their scores and divide by the number of evaluators and award the contract to the top ranking firm. Rather, another means of accounting for different rankings must be found. One alternative is to award points depending on the rankings of each individual and to award the contract to the firm with the most points. Another is to make relative ranking a group decision, after individuals have formed their own initial judgements.

Effect of different approaches to scoring

To simplify the problem, suppose that three companies submit proposals each of which must be scored out of 20. Below is the assessment of three evaluators:

	Evaluator 1	Evaluator 2	Evaluator 3	Average Score
Firm A	18	16	15	16.3
Firm B	16	18	10	14.7
Firm C	20	20	71	5.7

Evaluators 1 and 2 use a relative system in which the best firm is given 20 then next best 18 and the third place firm 16. Evaluator 3 uses an absolute scoring system in which companies are graded based on how well they replied to the requirements— giving even the best firm only a 75% score. As a consequence of this mixture of methods for grading, Firm A wins (has the highest average score) despite the fact that 2 of the 3 evaluators believe that Firm C is the best. In addition, had evaluator 3 used the same method as the other 2 (giving 20 points to Firm A, who evaluator 3 rates highest, 18 point to B and 16 points to C) then Firm C would still win. Therefore, simply because different people used different approaches to evaluation, Firm A wins when the selection panel actually believes that Firm C is the best.

The same point arises when all evaluators use the same method (i.e. relative or absolute) but use a different range of values (e.g., one evaluator gives an excellent proposal a 19 or 20 and a good proposal a 17 or 18 while another gives an excellent proposal something between 18 and 20 and a good proposal something between 15 and 18).

One method to overcome both of these problems is to agree scoring bands beforehand. Scoring bands are ranges that all the evaluators will use in assessing the evaluated categories.

Recommendation 7.8: The scoring system, including appropriate ranges for each category being evaluated, must be agreed prior to opening any proposals.

Interviewing proponents

Interviews may be a useful way to discriminate among potential candidates. However, they are only effective if the process is carefully thought out, questions framed and marking schemes agreed. If they are an addition to the written proposal process then they will add to the cost of the proposal preparation—adding not only time but also the cost of travelling and staying at the location of the interviews⁹. Therefore, it is

⁹ Ultimately companies will seek to recover these costs and may do so simply by increasing the cost of undertaking the project should they win.

important to decide prior to issuing the request for proposals whether interviews will be required and their place in the evaluation process.

If an interview, or beauty parade, is used to select the winning company or consortium then the interview should include a number of stages. A successful interview (i.e. one that allows the evaluators to effectively discriminate among the companies and select a winner) should:

- (1) Allow the team being interviewed to present itself, its qualifications and management (if a written proposal has not been submitted in advance).
- (2) Allow the team to outline its methodological approach.
- (3) Provide considerable time for detailed questions that the panel should decide on ahead of time (although follow-up questions may be framed on the spot depending on answers to the set questions).

It is particularly important that the interviewing panel contain at least one person with sufficient expertise to ask technical questions of each company. This often means that the panel will rarely be composed solely of civil servants or government officials.

A consistent structure for the interview should be developed and sent to each of the competing companies to ensure a fair process. As much as possible the time allowed under each category and the number of questions should be the same for each company.

If this method of selection is used it is important to be aware of its shortcomings when evaluating teams. In particular, companies will often send their best speaker when, in fact, the project will be undertaken by a large number of people. The ability to speak well at an interview may or may not be an important skill for the project in question and the person may or may not have a large role in the project team.

7.2.7 Negotiating the advisory contract

After the evaluation process has been completed, the evaluation panel should be agreed on the preferred advisor. The evaluation panel is encouraged not to inform the other leading bidders until a preferred bidder has been selected and a contract agreed. Once a contract has been signed, unsuccessful bidders should be given full and honest feedback in order that they may improve their bids in future. A useful test that can be applied to assess whether the selection process has been fair is that the feedback given to unsuccessful companies should link the reasons for lack of success with the selection criteria.

Concluding terms with a preferred advisor should be undertaken by those in procuring organisations who have experience in negotiating contracts, fees and appointment arrangements. It must take account of relevant legal requirements with respect to post-tender negotiations, where applicable. Where money has been granted or borrowed from a multilateral or bilateral agency, they may provide support in negotiating the final contract—and in some cases the final contract will be between the donor and the advisory firm, rather than the government and the advisory firm.

Ideally, the amount of post-bidding negotiations should be kept to a minimum, since doing so places significant power in the hands of the preferred advisor. One of the reasons for sending out a draft contract to potential advisors is that it should reduce the scope for extensive negotiation. However, there is a possibility that some changes will need to be made to the draft contract, relating to the fees or the range of deliverables that the advisors agree to provide. This is a further argument in favor of a selection procedure that forces bidders to submit a price for their services. Procedures that depend on negotiating a price with the highest scoring technical team are inevitably much longer and more arduous.

Recommendation 7.9: Post contract negotiations should be kept to a minimum. To maintain some pressure on the preferred bidder, lower ranked companies should not be told they have lost until a contract has been signed, at which point they should be informed of the reasons for losing. This explanation should, ideally, link the reasons for losing to the selection criteria.

7.2.8 Informing unsuccessful proponents

As outlined in Module 2 in *Volume I*, one of the most important factors in successful procurement is ensuring a high quality shortlist. This depends on convincing companies that they have a realistic chance of winning. If the government is planning to let multiple contracts for advisory services (a very likely occurrence) then ensuring companies continue to bid requires that they be briefed when they lose.

The purpose of the briefing is to encourage the companies that lost to bid for future projects, and to improve the quality of the bids. Therefore, the briefing should focus on the reasons they lost (e.g., too expensive, lacking someone with a particular expertise, methodology that did not meet the requirements in the TOR) in order to allow them to submit subsequent proposals while keeping these factors in mind.

Recommendation 7.10: Briefing unsuccessful companies provides a way of improving the quality of proposals in the future. Again this explanation should link the reasons for losing with the selection criteria.

7.3 Advisors' proposal strategies

When appointing advisors it is useful for government officials to be aware of the strategies that potential consultants might employ when bidding for government advisory contracts. In the case of selection criteria that are heavily weighted toward price, proponents may offer a low bid to secure the extra points. In order to minimize costs and maximize profits, firms may be tempted to offer senior staff in the proposal stage and then replace them with more junior and cheaper staff once the project is underway.

7.3.1 Low bidding

When cost is a significant part of the selection criteria, advisory firms may find it to their advantage to bid at an aggressively low rate – even below their expected costs. This type of strategy may be employed for a number of reasons:

- **Market entry strategy** One common strategy that some companies have adopted when they are keen to develop a new area of activity is to bid below

cost to ensure success. Their motivation will be to use the project to build up their track record in a new area that they can then use as a springboard for winning other work of this type.

- **Geographic expansion strategy** A similar strategy to the market entry strategy is a geographic expansion strategy. Rather than wanting to develop a new area of activity, a company may wish to expand the number of areas in which it operates. Again the company will have an incentive to bid below cost to ensure success.
- **Prestige projects** Companies may have incentives to bid below cost for projects that will bring them prestige benefits and may heighten their profile. An example of such a project might be a large privatisation in a country that is introducing PPI for the first time.
- **Predatorial bids** An incumbent company operating in a market may bid below cost because it is reluctant to let a potential competitor into the market.

Generally, government officials should treat low bids with caution. While the purpose of the low price may be to build up a reputation in an area, once the project has been won, there is a strong temptation either to renegotiate for an adequate budget or to undertake below quality work. In addition, problems of conflict of interest are much more prevalent: it is in the company's interest to try to increase the size of the contract in order to recover the money it has lost. Furthermore, only companies that are able to cross-subsidize certain activities will be in a position to use this strategy, which immediately limits the types of expertise available to the government.

7.3.2 Downgrading quality of inputs

A strategy that consultants might use to reduce costs and maximize profits, is naming a strong team in the proposal but using less experienced advisors to actually undertake the work. This is sometimes known as "bait and switch". This strategy is likely to be more prevalent amongst advisory companies who are unlikely, or reluctant, to seek repeat business.

Elements can be built into the contracts between the government and advisors to ensure that only the people named on the proposal work on the project. For example, contracts typically stipulate that only named personnel are permitted to undertake work on the project, and that team members can only be changed with the written permission of the government. Alternatively, the scheduling of presentations and workshops into the timetable can offer a way of checking whether the people named on the team have actually undertaken the work themselves.

The use of contractual elements to prevent "bait and switch" will need to be credible and carefully thought out. It should be noted that there are costs (for example, the costs of retendering) associated with the cancellation of contracts which may make government officials reluctant to do so.

It is also vital that the marking scheme for the technical proposal takes account not only of the expertise of the named individuals but also the amount of time they will actually spend working on the project, especially within the client's offices or country.

Recommendation 7.11: Be cautious of low bids, which may lead to pressure for renegotiation, or unsatisfactory outputs, and ensure experienced staff will actually be used on the project.

7.4 Advisors' conflicts of interest

Advisors may seek to protect their profits by inappropriately serving two clients on the same project, by providing advice which affects their own fees or even by accessing confidential information during the bidding process. These actions fall under the category of conflicts of interest. In the area of PPI advisory services such conflicts may occur when:

- advisors working for the regulator or the government are also working for potential private sector investors;
- an advisory firm has any relationship or ties with the operators (or their subsidiaries) who will subsequently apply to undertake the PPI;
- a transactions advisor is being paid a success fee by the government or public sector sponsor while also advising on issues that would affect sale value (e.g., regulatory framework, tariffs) unless these are issues (such as sale design) where the government's objectives are purely financial;
- an official involved in the reform program agrees to work for one (or several) of the companies competing for the contract (or the successful company); and
- a company that has advised on the drawing up of the TOR is invited to tender for the subsequent project.

In other words conflicts of interest arise when the incentives of the advisor are not aligned with the incentives of the government. Two points must be closely observed when managing conflicts of interest. First, the government must ensure that advisors do not have material conflicts, and replace them if they do. Second, if the pool of advisory talent (particularly within the country) is thin and local consultants are required on bids then the government must put in place processes that clearly define conflict, and sensible tests of materiality, as the basis for its decision making.

Problems can arise when there is a requirement for foreign advisors to team up with local advisors, but the latter are few in number. One approach might be to allow the local advisor to associate with several consortia. This raises challenges of a different sort. Under these circumstances, local advisors should not expect to learn the details of each bid on which they are included because of the danger that details will be passed on to competing consortia. Another approach might involve local advisors being hired on a sole-source basis and then requiring the successful advisors to work with the local advisors.

Potential conflicts of interest may be qualified by a test of materiality, where materiality refers to the importance of the work. Where a company's advice is felt to be so material that it will subsequently be prohibited from working for bidders, this needs to be made clear prior to its appointment.

7.4.1 Declaring conflicts

The normal way to identify conflicts of interest is through self-declaration by advisors. Where a conflict exists which has not been declared, competing companies are likely to bring this to the attention of the project manager. All conflicts should be declared. The project manager should then form a view about whether the conflicts are material, and take action accordingly.

7.4.2 Chinese Walls

One approach to avoiding the problem of conflict of interest is through the use of “Chinese walls” to avoid the flow of valuable information from one part of the advisory company to another. This could help overcome the problem that there is often a limited number of people who can provide specialist advice on specific topics, and many of them work in the same companies.

While in theory Chinese walls should minimize the risks of conflicts of interest, in practice, government officials ought to consider how realistic it is to expect these to operate effectively. If they feel that this mechanism is not strong enough to prevent potential conflicts of interest, or the appearance of conflicts, then they should not proceed with appointing advisors on this basis. Officials may wish to check the extent to which advisory companies have internal written protocols or codes of practice to enforce Chinese walls. As a general rule, larger companies will be more capable of adopting a Chinese walls’ approach than smaller ones. Companies with good reputations will have stronger incentives to make this work.

Chinese walls are not efficient where there are very obvious conflicts. However, they may be appropriate where a firm provides a smaller, specialist input. Where government officials rely on Chinese walls to prevent conflicts of interest, they should be aware that there may still be a risk of an outside perception that conflicts of interest exist. This perception could undermine the PPI reform as much as the presence of real conflicts of interest.

Recommendation 7.12: Project managers should establish a system for identification of conflicts of interest at the start of the process. Advisors and staff in the project management unit should be required to declare any conflicts. Where conflicts are material, advisors and staff should be ineligible for appointment.

Recommendation 7.13: Chinese wall arrangements should be limited in their use and carefully vetted by the government.

7.5 Corrupt relationship between advisor and government

Irrespective of how transparent the selection mechanism is for hiring advisors, there is always the possibility of corruption. Ultimately corruption will manifest itself in an award of the contract to a company or individual for reasons other than they are the best-qualified proponent. Corruption in the process of selecting and hiring advisors might arise when:

- a member of the selection panel has an undeclared interest in one (or more) particular advisor bidding for the contract;

- one of the potential advisors is privy to information that will put them at an advantage during the tendering; and/or
- one of the potential advisors proposes to advise the government in a particular way because they have been encouraged to do so by the future operators.

The key to minimizing the risk of corruption is the establishing of clear rules and procedures to be followed throughout the process of hiring advisors. For example, it would be desirable to have procedures in place to allow government officials to declare any gifts that they have received from potential advisors or bidders for the project. It might also be appropriate to have a code of practice that sets out any restrictions on companies or individuals that wish to bid for the contract and behaviour during the tendering process. In addition, most of the donor agencies have strict guidelines for ensuring that corrupt practices are prevented and, if uncovered, severely punished (e.g., prohibiting the company in question from any future work). They also often have a list of qualified companies/individuals who are eligible to undertake consultancy work for the agency in question. Many of these lists are publicly available.

Useful reading

Trivedi, P., *How to Implement Privatisation Transactions*, Routledge 2000

McFee, R. *Incentives in Government Contracting*, University of Toronto Press, 1988

Dufwenberg, M. and Gneezy, U. *Procurement and Information Feedback*, University of Stockholm Discussion Paper, March 2000.

8. Paying advisors for their advice

Outline of Module

What this Module does:

As indicated in Module 7, the appointment of advisors should generally follow a competitive tendering process. This module considers the ways in which advisors can be remunerated once they have been selected. In particular, it looks at the appropriate mix of success fees, time and material contracts and fixed fee contracts. The module also covers ways of rewarding innovation and discusses the issue of how risks should be allocated and contracts structured.

Who should read this Module:

This module should be read by managers of major reforms who are involved in design or negotiation of major contracts with advisors. This group of officials ranges from middle level civil servants located in the PPI unit or office heavily involved in recruiting advisors right through to senior officials who might be required to approve and sign contracts, as well as officials with financial and procurement responsibilities.

Substantial funds are spent on advisors. Managers of major reforms need to consider how best to structure those contracts to maximize value for money. This module describes a number of different approaches, and the situations under which they are appropriate.

8.1 Fixed fee contracts

For the purposes of PPI projects, the majority of advisors - economists, engineers and perhaps legal advisors - will normally be retained on contracts which either give them a fixed fee for delivering specific outputs, or which pay them on a time and materials basis for providing specific inputs.

The main risks in purely advisory contracts relate to the cost of the services and the quality of the output. Fixed fee and time and materials contracts allocate those risks differently. Fixed fee payments place the majority of risk related to costs on the advisors and, as a result, there will be an incentive for advisors to take short cuts on quality, with associated risks for the government.

Because fees are fixed, after the contract is won the company or consortium may have an incentive to reduce inputs against levels they had originally planned. They can do so by reducing the time input, or using lower cost staff, or by reducing 'out-of-pocket expenses' such as travel costs to increase the profit margin. These incentives to reduce inputs need to be offset by an ability to enforce quality standards.

The greatest difficulty under fixed fee contracts is therefore assessing quality. There are a number of ways of strengthening the government's ability to assess quality. Governments could:

- **Rely on companies with a high reputation** All purchasers of advisory services face the same problem: that there are many providers of services, but it takes

time to assess the quality of the advice they provide. The normal response in markets of this sort is to rely on reputation as a signalling device, perhaps through the use of Past Performance References (PPRs). Where companies have a high reputation, they have more to lose if quality is low.

- **Rely on lead advisors** Where lead advisors have strong incentives to deliver, they will also want to ensure that sub-consultants perform promptly and well. However care should be taken to avoid potential conflicts of interest. In particular, sub-contractors often see lead advisors, rather than the government, as the client and this could lead to a lack of clarity in sub-contractors' objectives.
- **Use peer review** The market for advisory services is highly competitive. Another firm can be retained to review the quality of what has been produced. This normally requires relatively little time or expense. It cannot be used to fine-tune quality (since fine differences could be explained by difference of approach among the two companies). It can be used to ensure that low quality advice is not being provided, or important issues completely missed. However, the competitive nature of firms may raise the risk of undue criticism. Moreover, an outright condemnation of work from a peer reviewer can undermine the public confidence in a project and delay project implementation. As a result, peer review is often provided by donor agencies or governmental peers so as to guarantee objectivity.
- **Hire two firms to perform the same task** Where advisors' input could be crucial to the success or failure of the proposed reform, governments might consider using two sets of advisors to undertake the same task. For example, this might be an option where asset valuations are needed.

All of these potential quality control mechanisms are of lesser importance than careful selection and contract monitoring. A fixed fee contract works best when if output is clearly defined, quality can be measured and the advisor can control the risks associated with delivering the output. This is likely to be the case for most of the advisors outlined in Module 3, with the possible exception of the financial and legal advisors.

Recommendation 8.1: Fixed fee contracts should be used where the output is clearly defined and measurable. They may be combined with control mechanisms to enhance quality standards.

8.2 Time and material contracts

Time and materials contracts transfer cost risk to the government. Therefore, they need to be matched with systems for managing total fee costs and quality of output. However, the incentives to maintain high quality are greater than under fixed fee contracts. Companies have incentives to put more resources, especially more senior ones, onto the job and this will often result in higher quality.

Time and materials contracts are generally awarded for assignments in which the total input is difficult to define at the stage when the project is bid. This tends to be true of activities that come late on in the transaction. For example, the amount of legal

drafting will not be clear until other stages of the project are completed and will be affected by the response of the bidders to the proposed contract.

There are only a limited number of ways to manage cost risks. Possibilities include:

- Agreeing in advance to a reduction in unit fee rates if the volume of work exceeds an agreed level. Companies are often willing to accept lower fee rates for jobs which give them a large volume of work in a short period of time.
- Agreeing in advance to a cap or ceiling on the total billings. While this approach limits government risk, final cost may be difficult to anticipate and the consultant will be incentivized to bill up to the cap.
- Seeking, where possible, to transform open-ended time and materials contracts into fixed fee contracts for particular outputs. It may be possible to define new outputs and agree a cost for meeting them as the transaction proceeds.
- Ensuring that the time spent is carefully monitored for each individual team member and approved by the project manager – for example advisors might be required to provide an hourly breakdown of the time devoted to individual tasks or a monthly invoice that is subject to mutual agreement. This requirement for careful, detailed monitoring imposes additional costs in itself.

In practice, as major transactions near finalization it may prove very difficult to put any of these mechanisms in place to limit costs. It may also be difficult to know who performed each task and to determine the work undertaken by each team member. However, both investors and the government have an incentive to reach financial closure as rapidly as possible. Hence real time constraints may limit the total cost of any open-ended time and materials contracts.

Recommendation 8.2: Officials should use time and material contracts where it is difficult to determine the exact range of outputs that will be required. Nevertheless, as far as possible, the TOR for work undertaken on a time and materials basis should attempt to detail the proposed time and material input.

Although termed ‘time and material contracts’ many technical assistance contracts are de facto fixed fee contracts. Much of the work may be undertaken offshore and it is not possible to assess who is doing it or how long it takes. In practice, the firm gets paid provided the output is delivered to acceptable quality by the due date. At the same time, in appearance, they are time and materials contracts because bidders are required to build their cost proposals based on time inputs of individual staff; related fee rates; and other costs.

This has a number of advantages. If quality is not easy to assess, then inputs by appropriately qualified staff may be one proxy. Gross divergence from agreed inputs can then be monitored. The individuals named also have an interest in preserving their personal reputation. The contracts also make it easier to negotiate further work, since fee rates have been agreed upon.

Recommendation 8.3: Where advisors are paid for output (and so apparently a fixed fee), details of their proposed inputs will assist contract management.

8.3 Bonus and success fees

Contract theory shows that risks should be allocated to the party best able to manage them. Payment of success fees is the most usual form of substantial risk transfer under advisory contracts. As the term implies success fees result in advisors being paid a fee based on a successful outcome. The definition of a successful outcome may have a number of dimensions reflecting monetary values (such as the market value of a transaction or level or tariffs) or non-monetary objectives, such as the completion of a transaction by a particular time.

Success fees may be a lump sum, a share of the sale or some other value, or a share of value above a target level. In addition to the success fee, it may be appropriate to accompany the contingent payment with a retainer. The balance between the two will reflect the extent to which the government wishes to incentivize their advisors, and the extent to which a successful outcome is under their control. Common estimates for the size of success fees are in the range 0.2% to 3% of the transaction value, depending on the country concerned, the size of the transaction and the market conditions.

8.3.1 Measuring success fees

Success fees are appropriate when:

- it is possible to measure and quantify success in meeting government objectives;
- when success is at least partly related to the efforts of the advisors involved; and
- when it does not generate a conflict of interest.

Within advisory services, success fees are usually reserved for the successful completion of a PPI transaction (e.g., sale of a government owned company). By that stage it is generally possible to measure success in dollar terms, and success fees give an incentive to increase sale revenues. The value of other advisory work cannot normally be measured directly.

It is a mistake to base advisors' incentives on sale revenues at an early stage. In general, governments have objectives that are not purely financial. The structure for private sector participation should reflect those broader objectives. Once that structure is in place, the government's objectives may become more purely financial – to maximize sale revenues (or minimize required subsidies) within an agreed framework.

The power sector provides a clear example. Many electricity reforms to-date have created several generation companies, and introduced competition in generation, as a way of protecting consumer interests. However, sale value of generation assets would be higher if competition were not encouraged, and if a smaller number of generating companies (or only one) had significant market power. Introducing an incentive based on sale value for advisors' remuneration at too early a stage runs the risk that the government's objective of increasing competition is neglected, as it does not increase sale value (and is likely to reduce it).

Recommendation 8.4: Success fees should generally be limited to the final transaction stage of advice. By that time the government's objective is to bring the project to financial closure. Success fees should not be introduced before the broad structure of sector reform has been determined.

8.3.2 Restricting the use of success fees

Success fees should be reserved for advisors whose efforts will have a significant impact on sale value or other definable government objectives. The bankers handling the sale are the most directly concerned. Bankers can affect sale value by:

- working to attract a large number of qualified bidders; and
- by ensuring the transactions team delivers appropriate and timely information to bidders.

The largest trade sale in the world to date was during the Victorian power sector reforms and demonstrates the ability of bankers to generate interest in a sale and increase the revenue to the government. Commenting on the power sales during the sale period, the Treasurer of Australia wrote:

*"...trade sales were vigorously contested. Buyers who at first asked 'what is this business worth?' were by the close of bids asking 'what do we have to do to win'."*¹⁰

Bankers played a major role in achieving that shift in bidder attitudes, assisted by a process with a high degree of transparency and disclosure. The strong preference of the government for fully financed bids enabled close adherence to the timetable indicated in advance, also increasing confidence.

More generally, a handful of other key advisors may also play a role in changing attitudes. Legal advisors tend to be heavily involved in final negotiations with bidders. Non-banking financial advisors may also be influential.

The decision of which advisors should be provided with incentives through success fees needs to be taken separately for each transaction. This decision should be reached by asking the following sorts of questions:

- Is success or failure of the project directly related to the performance of advisors?
- Are there risks that could affect the outcome which are beyond the control of advisors?
- Will the lead contractor be able to extract the best performance from their sub-contractors in the absence of success fees?

If the answers to any of these questions is 'yes', then officials should think carefully about using success fees.

Recommendation 8.5: Success fees should be reserved for the small number of advisors whose efforts can have a significant impact on value.

8.3.3 Alternative approaches to structuring success fees

Success fees need to give advisors incentives to improve the result through increasing their efforts. That requires a decision on two parameters: the measure of value against which advisors will be rewarded and the structure of the incentive. The basis for such a decision is an estimate of what result is achievable, and what more could be achieved through increased effort.

¹⁰ "The politics of privatisation in Victoria", Alan Stockdale, in Privatisation International, November 1999.

Sale of the Victoria Plantations Corporation

Australia's Victorian Plantations Corporation (VPC) was a state owned enterprise. VPC owned and managed 108,000 hectares of softwood plantations and 7,000 hectares of hardwood plantations, covering an area of around 166,000 hectares. In 1998 the Government of Victoria began preparing to sell VPC. Independent estimates of market value were A\$177 to A\$246 million, depending on the discount rate used.

Total advisory costs for the sale were around A\$7million. A transaction advisor was retained at an estimated cost of A\$4million. The transaction advisor was entitled to a further performance bonus of A\$0.5million provided that the sale was finalized no later than March 1999 and the sale proceeds exceeded A\$350million. Hence the definition of success that was used had two dimensions to it – time and money.

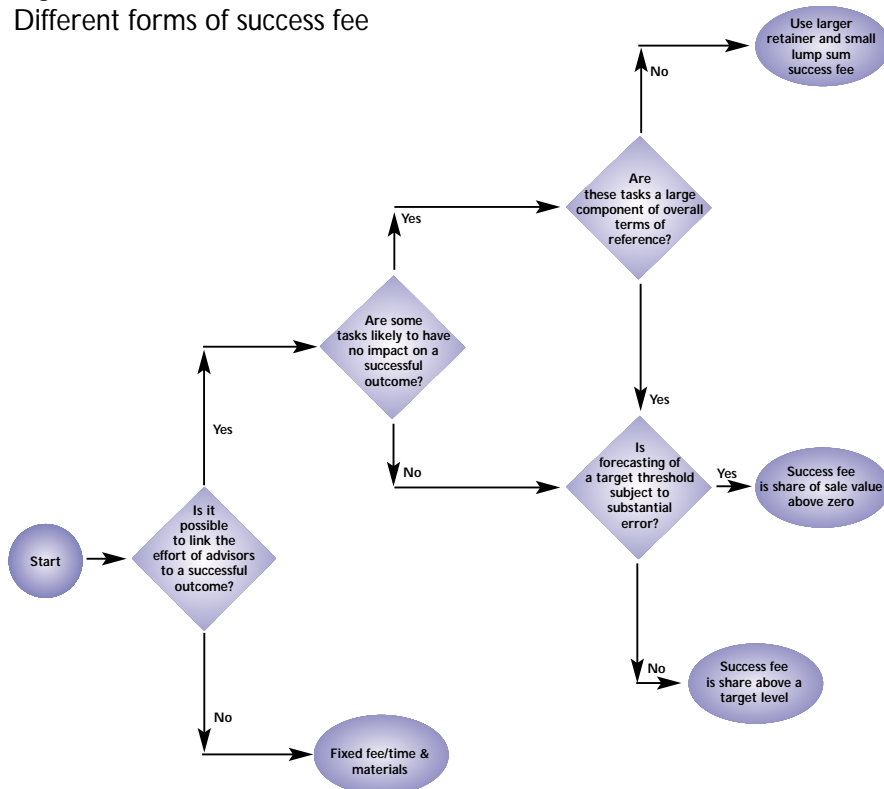
The sale of the business was announced in November 1998. Total sale proceeds were A\$550million.

Source: General Report on Ministerial Portfolios, May 1999

Achieving a target above a certain value

One approach to establishing the basis for success fees was discussed in relation to the sale of the Victoria Plantations Corporation. A financial model can be used to estimate possible market values, based on discounted future cash flows. It is important that this estimation is carried out by independent experts; in other words, advisors who have nothing to gain from forecasting any particular valuation. The transaction advisor is then given an incentive to exceed the original valuation or expected payment.

Figure 8-1
Different forms of success fee



Unfortunately, as the example illustrates, forecasting is not an exact science and hence the approach generates the risk that the fees to advisors will reflect forecasting errors rather than their efforts to increase the market value. Notwithstanding this risk, however, a target approach has the merits of being defensible and establishing appropriate incentives, so far as can be done with limited information before the sale.

Achieving a positive sale value

An alternative to setting a target is to offer bidders a share of sale value¹¹ above zero, rather than sale value above a target. This approach requires less analysis. The disadvantage is that the asset or business being sold may well have a positive value that could be realized regardless of effort by the advisor. If they perform poorly they are still receiving a substantial payment. In theory this should be reflected in the bid price (advisors will bid less in fees if they expect to receive more in bonuses). In practice, it may prove harder to defend following the sale.

Lump sum or sliding scale?

The structure of the incentive can be a lump sum, as in the Victorian Plantations example given. Alternatively, advisors can be given a sliding scale. This would give them a share in sale proceeds, or in sale proceeds above a target figure where the share is increased the more the advisor exceeds the target.

In theory, advisors should reflect the expected value of success fees in their bids. However, estimating sales value and thus success fees is difficult, particularly at the early stages of a project. Bidders may attach little value to the probability of sales value (and success fees) at the top end of the scale. It may therefore be desirable to taper incentives, or to put a cap on the total level of success fees when considering large success fee payments. It should also be noted, that sliding scales may be doubly punitive in circumstances where failure occurs for factors beyond the control of advisors.

Balancing a retainer with a success fee

Generally the range of tasks that transaction advisors will need to undertake will comprise two groups. There will be those tasks that have a direct bearing on the outcome and those which need to be performed for the transaction to be completed, but will have little or no influence on the outcome. Where this occurs, it may be desirable to accompany the success fee with a retainer. The balance between the two will reflect the extent to which the range of tasks that the advisors undertake will impact on a successful outcome.

Recommendation 8.6: Success fees should give advisors an incentive to increase sales value or meet other government objectives. The appropriate structure will vary from case to case but should consider the achievable transaction goal, the relationship of the incentive to better sales performance, and the nature of any cap on the total fee.

8.3.4 And they can sometimes be used for sale of loss-making franchises

Where governments are selling assets, bidders will pay for the rights to the future profit stream associated with those assets. However, as discussed in other modules, governments may also be trying to increase private sector participation in loss making sectors. For a variety of reasons, governments may have a policy of particular services being run at a loss. The losses involved could be reduced if the rights to

operate the service and earn the revenues are competitively tendered. Examples include the competitive franchising of water services and of public transport.

In theory, the incentive for advisors can be structured in the same way. If effort by advisors can increase revenue from the sale of a profitable entity, it can also reduce losses from tendering out a loss making service. In the same way, that incentive could be based upon an improvement over the losses the government currently incurs, or over an informed estimate of the subsidy likely to be required if the franchise is tendered out. A key challenge of this approach is that loss-making services may often be characterized by cross-subsidies and hence it will be difficult to estimate the overall level of subsidies for a sector at any point in time.

Recommendation 8.7: Success fees for the sale of loss-making franchises can provide similar incentives to improve the financial outcome for government.

8.3.5 Success may not just relate to the financial result

The most direct incentive is financial: whether to increase revenues or reduce losses. It is also possible to provide bonuses if specified outputs are delivered by a target date. Since transactions have clear milestones and it is often politically important to reach them by particular dates, advisors may be provided with incentives to stick to timetable. For example, transactions may need to be completed before an election. If timing is particularly important, this can be reflected in advisors' contracts. Bonuses can be offered for on time (or early) delivery of outputs on the critical path for the reform and transaction. However, in general advisors should be provided with sufficient incentive to deliver projects on time by the refusal of the government to pay their basic fees if the output is not produced, regardless of the payment structure.

8.4 Combination contracts

In addition to the main payment structures identified above, other forms of payment are possible which combine some or all of the above. For example, one combination might include a fixed fee to undertake those tasks that are easily definable, together with payments on a time and materials basis for additional tasks not specified in the initial TOR. As discussed, that is often the de facto result of many technical assistance contracts. Legal advisors may also have a mix of defined outputs, and an open-ended response to legal issues that arise late in the transaction.

8.5 Advisors can be retained on indefinite quantity contracts

Indefinite quantity contracts (also termed framework or drawdown contracts) refer to contracts in which an individual, company or consortium is hired for a specified, usually medium-term (e.g., 3-5 years), period to undertake tasks as and when the need arises. In other words, the specific workload is unknown at the outset, and all that is known is that advice is likely to be needed in a particular area.

In some cases government may be required to use Indefinite Quantity Contracts (IQCs) if they receive funds from certain donor agencies (most notably USAID, TACIS and PHARE). However, if governments are under no requirement to use IQCs, there may still be a case for considering their use anyway.

IQCs are usually signed because it is anticipated that this advice will have three particular characteristics:

- it will be required at short notice—making a lengthy competitive bidding process unacceptable;
- each individual piece of advice will be relatively small - making an expensive competitive bidding process inefficient - although added together the amount of advice is substantial;
- the general nature of all of the components of the assignment can be anticipated allowing a broad evaluation of the amount of advisory input that will be required.

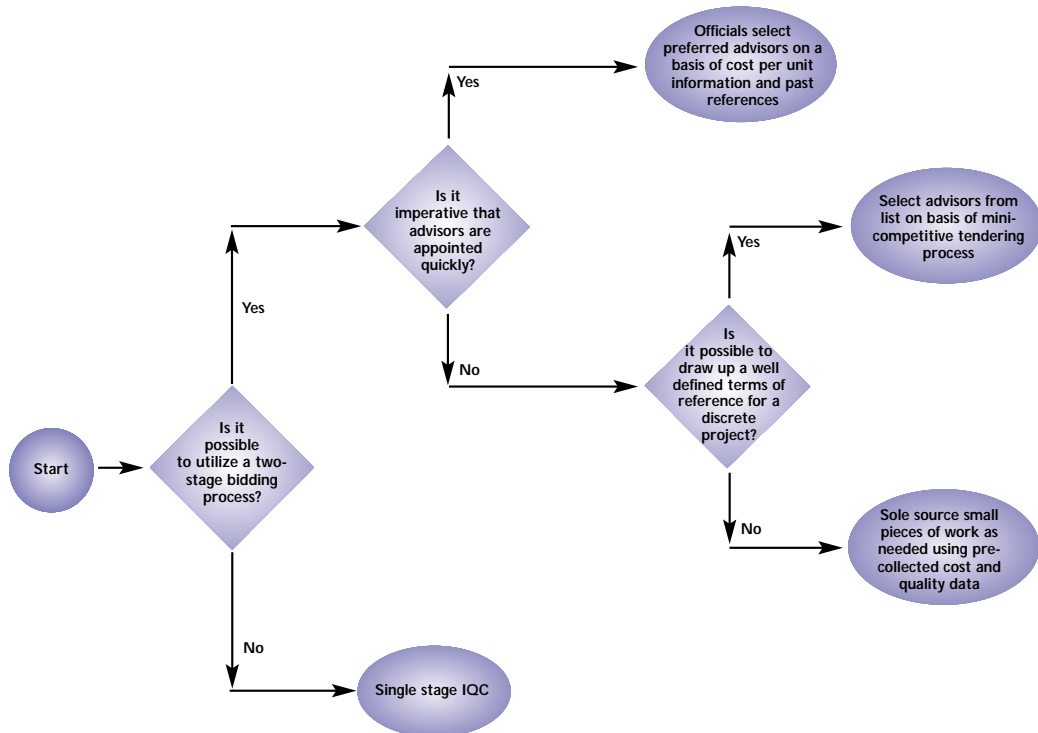
A combination of these three factors may mean that it is worth considering holding a competitive process to select a suitable advisor or set of advisors who can then be called upon when needed.

The process for deploying IQCs varies from agency to agency. A key factor which often differs across agencies is the extent to which different agencies use multiple rounds to determine which advisors are to be awarded contracts on this basis.

Some agencies (eg USAID) have multiple selection rounds before awarding IQCs. For example, at the start of a major reform, a government or agency may draw up a list of firms which will be invited to tender for specific projects over a period of time. The list itself will have been devised on the basis of a competitive tendering process, but also when the need for advisory services arises, firms on the shortlist may be asked to submit a brief proposal. If a multiple round process is to work effectively then the short list should be very small (preferably no more than three companies) otherwise the chance of winning enough projects to maintain interest is remote. Alternatively the shortlisting process should allow the government to invite a selection of advisory companies on the list to submit a proposal. Since the whole point of the indefinite quantity contract is to avoid having to go through the competitive tendering process each time a small job is required, the only way this process will work is if it is clear and transparent.

Others agencies have a more condensed single-round process where pieces of work are sole-sourced to one advisor (or advisory firm) that has been selected competitively at the start of a reform. This approach may be appropriate where advice is required at short notice, where the value of individual contracts is small or where the market for suitably qualified advisors is thin.

Figure 8-2
Different approaches to IQCs



Hence IQCs provide agencies with the flexibility to sole source or hold a quick competition as appropriate. However, by locking-in one set of advisors over a considerable period of time such contracts raise a number of issues that must be addressed.

The main issues are:

- How will companies be selected?
- Will individual companies or pre-formed consortia be selected?
- Will a short-list of companies be maintained or one company selected for each required speciality?
- Will a formal contract be signed with the advisory company(ies) for the entire period or for each project as they arise?

8.5.1 Selection for IQCs: firm and individual capability

As with any other bidding process, the selection of the advisory firm or consortium to undertake the contract can involve any of the combinations of technical and financial criteria as outlined in Module 7 (see Section 7.1.2). However, the long term, undefined nature of these contracts provide particular challenges. Most notably, since it is not known how often or for what precise tasks advisors will be called upon, they may not be able to submit assurances that specific individuals will be available, a work plan, a methodology or a fixed total price¹².

¹² Under some indefinite quantity contracts potential advisors will be able to present a methodology. For example, if a country is creating many regulatory offices (say, in each of many states) then an indefinite quantity contract may be signed so that as each state reforms the potential advisors are called in to set up the regulatory office. Under these conditions, it is possible for the companies to submit a detailed methodology covering how they would set up a regulator.

Consequently, evaluation must typically be based on the general capabilities of the companies in the area under question and the cost per advisor per hour of using their advice. However, the choice of consultancies based on unit price may result simply in the cheapest advisors being appointed—hence the desire for combining price and quality.

An important question that must be considered is whether the selection will be based solely on the company credentials or on those of individuals as well. In typical contracts, selection is weighted towards the individuals because they will be the ones actually undertaking the work. However, the uncertainties of indefinite quantity contracts (both in terms of the specific expertise required and whether specific individuals will be available in 2 or 3 years time) argues in favor of shifting the weighting towards company capabilities.

If naming individuals is favored (e.g., if there is a desire to ensure that a specific person with a particular skill is available) it is important to recognize that the long time period and unknown activation dates means that advisory firms may always be able to credibly claim that the requested individual is not available. Therefore, it is important to include in the contract clauses that allow the unit price to be adjusted according to the advisor who actually does the work and to ensure the work is to the quality that is expected of the person originally requested. Another method of trying to ensure that individuals named by the company in the original proposal remain active is to ensure that the company believes there is sufficient money available to make it worthwhile. If they anticipate that they can receive a substantial amount of money as long as the right people are available when called upon, there is greater incentive to provide those people.

Assessing the quality of companies and individuals in this field is difficult. When no specific job is being offered and the nature of the work is hard to anticipate in most cases there is no technical quality that can be assessed (at least in the first round of the bidding process for IQCs). Consequently, more general measures of capability must be evaluated, including:

- **Depth of experience** Both academic and practical – with greatest weight being placed on operations undertaken in the last few (say, 3-5) years. Over a long term contract it is unlikely that the same few individuals will be available. Consequently, this criterion should evaluate not just the individual CVs put forward, but also the depth of experience in the company to make sure it could perform even if these individuals are unavailable.
- **Breadth of experience** The range of sectors, countries and problems that the advisors have tackled is important since the advisors are likely to be called upon to look into a wide range of issues that touch upon their core speciality.
- **Success of activities** Has the company undertaken similar assignments in the past and were they successful? Past Performance References (PPRs) might be sought, although they ought to be treated with some caution. Successful past experience may be hard to verify and poor performance may not necessarily be the fault of the advisor.

8.5.2 Controlling costs

As identified above, the main problem with using price to establish the preferred company is that since there is no known output to be priced, the only measure available to use is the unit price - i.e. the hourly cost of individual advisors broken down by salary and overheads. However this information is of limited value because it is not clear how advisory firms will build a team when the time comes to undertake a specific project. Nor will the lowest priced advisors necessarily provide the best value for money. Consequently many agencies that use IQCs assign a lower weight to price proposals at the first round of the process for awarding IQCs than they do for fixed budget assignments or for when soliciting second round proposals for specific projects.

A further consideration arises because, over the length of such a long contract, prices will rise and people are unlikely to accept being paid the same amount per hour or per day at the beginning of the contract as they will at the end, which may be 5 years later. Three main options are available:

- **Use of multipliers** Agencies accept that annual salary increases will occur and establish constant multipliers, based on salaries, that will be applied for the period of the contract.
- **Internalization of price increases** Agencies accept that annual salary increases will occur but force the company to internalize these in their bids (i.e. they may bid their unit prices higher than their current rates but lower than they will be by the end of the contract so that over the entire contract they receive the appropriate average rate).
- **Benchmarking** Agencies allow an external benchmark to determine fee increases, i.e. use a widely published index. One benchmark that could be used would be announced increases in fee rates for a professional group (e.g., lawyers, management consultants) as an average over the top ten companies. An alternative might be the retail price index in the firm's home country. A further option might be comparison against the rates that are quoted in data bases of individual consultants. If this approach is adopted it is imperative that the index be a public publication which neither party can influence and both agree is readily identifiable¹³.

Finally, it is important to recognize that over such a long period, staff may be promoted—increasing their fee rates. There are two main approaches that can be taken in this case:

- Accept the higher fee rate in order to continue working with the same individual; or
- Maintain the agreed fee rate and use a different individual—i.e. someone at the same level as the previous person prior to their promotion.

One approach to avoid problems with promotion is to agree a set of fee rates for different levels of people, rather than for specific individuals. In other words, agree that any Partner or Director will be paid US\$X per day, any Manager US\$Y per day and any consultant US\$Z per day. The government can then request the mix of

¹³ In addition, a clause should be included in the contract informing both participants about the appropriate procedure should the index discontinue publication or change the definition of its coverage during the contract.

personnel it requires for each assignment and pay accordingly without worrying about specific individuals. The agency must only be careful that the firm is not promoting individuals or changing their titles simply to increase their rates.

8.5.3 Use of individual companies vs consortia

Another issue that must be addressed is whether the preliminary IQC bidding process should be based around individual companies bidding for specific work areas (e.g., legal, economic, technical, financial) or consortia that are able to deliver the whole range of skills.

There are two main advantages of asking advisory companies to propose individually for projects that might arise and require their specific skills:

- the government can select the best companies in each area rather than consortia that are likely to include a mixture of higher and lower quality companies; and
- the government avoids excluding strong individual companies which are unable to form relations with a consortium.

However, consortia also have important advantages:

- companies who have already established a protocol to collaborate as a consortium may be better able to coordinate the best approach to any given project; and
- the job of determining the appropriate group of advisors and managing that group is internalized within the consortium rather than being a job faced by the task manager in the government.

Under most conditions, the improved coordination among members of a consortium would suggest the latter approach. This option must be weighed against the individual contract's advantage of ensuring that each company has sufficient depth of experience to provide advice over the entire period. If individual company approach is adopted, a couple of further procedures should be considered:

- **Management** The ToR could include the management of the final consortium in the list of tasks. If a suitably qualified company is willing to take on this responsibility then that would remove the risk of co-ordinating the consortium from the government.
- **Communication** Where government retains overall management of advisory contracts for a range of firms, there should be a process for ensuring that the right skills are mobilized for the task in hand.

8.5.4 Different approaches to contracting

Within a single round process advisors can be signed with a variety of contractual approaches, including:

- a permanent retainer that pays them a specific amount every year;
- a time and material contract for each piece of work they undertake;
- through the submission of a brief proposal with an estimate of a lump sum contract; or
- a separate lump sum contract each time a new project arises, possibly using a quick competitive price/CV based process where several advisory companies are placed on a short list.

Since the exact extent and nature of the services to be provided under an IOC are not known at the commencement of the contract, the contract typically specifies a per person/per day unit price for each form of service that might be required over a fixed term. At the end of the term, the contract will expire.

Such contracts are effective in ensuring advice can be made available rapidly without the need for cumbersome procurement procedures. However, they also severely restrict the choice of advisors and may well lead to problems where the actual services required differ substantially from those envisaged when the contract was initially signed. In addition, they create a temptation for the government always to refer to its pre-signed advisors even when the issue that arises is outside their main set of expertise.

Recommendation 8.8: Indefinite quantity contracts should be used with caution, when it is known that upcoming assignments will be too small to merit competitive selection, when it is anticipated that the turnaround for individual assignments will be very quick, and when the projects are spread over a sufficient time period that they cannot be grouped into a single competitively bid contract.

8.6 The phasing of payments for advisors

In general, advisors will seek to be paid up front as far as possible, for cash flow reasons. They may also prefer upfront payment where there is a possibility that the government will default on a payment. On the other hand, it is in the interest of the government to link payments to outputs which must be delivered to requisite standards.

For large projects, lasting more than several months, it would be unreasonable to expect companies to undertake work for which they will not be paid for a long time. Government officials will therefore need to establish a payment or invoice schedule that sets out the points at which the company will receive payments. Where possible it would be desirable to align payments with the completion of specific outputs. Such outputs might not only include delivery of the final product, but also intermediate milestones such as reports, workshops and presentations (also see Module 4 of *Volume I*). It is usual practice that a portion of the payment (and often the largest share) to be reserved until the final output has been signed off.

Where phased payments are adopted, then officials will need to consider the payment profile. As a general rule, the payment schedule should reflect the amount of input that advisors will put into each stage of the work.

An example of a payment schedule is shown in Table 8-1 for a small project involving the training of new regulators.

Table 8-1

Payment schedule for \$50,000 project involving training new regulators

Percentage	Amount (\$)	Milestones
20%	10,000	Delivery of appropriate teaching material to the project officer
30%	15,000	Successful completion of the workshops
50%	25,000	Delivery of an acceptable report setting out consultants' recommendations for further training

For smaller projects, payments after completion of the work is usually sufficient for two reasons: smaller projects will be less likely to have multiple milestones, and the difficulties of cash flow are less likely to be an issue for shorter projects.

Recommendation 8.9: Governments should establish payment structures that broadly reflect the cost of expected inputs, make payment against defined outputs, and retain some leverage for final delivery.

8.7 Standard contractual safeguards will be needed for advisory contracts

As discussed in sections 8.1 to 8.4, the form of payment can be a method of allocating risks to different parties. Fixed price contracts tend to allocate cost-related risks to the contractor, whereas time and material contracts tend to place that risk on the government.

The inclusion of contractual safeguards provides an alternative way of protecting government interests and minimizing its liability. One approach is for the government to draw up a document setting out the general conditions of contract for services. A key issue in contract design is the appropriate allocation of risk across the different parties involved – primarily the government and their advisors, although under some circumstances the government will need to consider the contractual relationship between its lead advisors and advisors' sub-contractors. Where sub-contractors are being used, it is usually the responsibility of the lead contractor to agree a contract with its sub-contractor. However, the main contract may need to ensure that the government is protected against the actions of sub-contractors to prevent, for example, the disclosure of confidential information or conflicts of interest.

The contract that the government draws up is likely to address some or all of the following issues:

- **Confidentiality** Disclosure of confidential information and retention of documentation. Advisors working on confidential issues may be required to adhere to government rules relating to the disclosure of confidential information and to return all copies of confidential information that is provided to them during the course of their work.
- **Receipt of gifts or payment of commission** Advisors will need to be made aware of procedures for informing the government of receipt of gifts or commission.

- **Merger, takeover or change of control** This would require the advisor to inform the government of any potential changes of ownership. This is important because any changes in ownership can be a potential source of conflict of interest.
- **Termination of contract** The conditions under which the contract can be terminated without notice. Possible grounds for termination include breach of confidentiality agreements by advisors, failure of advisors to meet requisite standards of performance, if the advisors cease to carry on their business or if there is a change of ownership of control.
- **The use of sub-contractors or change of personnel** The advisor might be required to inform the government if new sub-contractors are appointed or individuals other than those named in the team undertake the tasks included in the contract. This is important if substitution of personnel gives rise to conflicts of interest and may be grounds for termination of the contract.
- **Insurance** The contractor's responsibility to take out professional indemnity insurance and under which country's law's it should apply. This is usually the country of the contracting government, although it may differ if the funding sources are grant-giving institutions.
- **Insolvency of the contractor** The conditions under which the contractor needs to inform the government of bankruptcy or insolvency.
- **Arbitration** The process that will be undertaken in the event of a dispute.
- **Exchange rate fluctuations** The contract will normally state the currency that the payments are to be made in and the arrangements for reimbursing expenditures arising in foreign currencies.
- **Payment of local taxes** The contract will need to specify which local taxes will need to be paid and whether the sums invoiced will include taxes.

While the contract between the government and its advisors provides the government with a degree of security, it should only be relied upon as a safeguard of the last resort. Ideally, if problems with advisors occur, these should be discussed openly and settled during the course of the project. Furthermore, even though the contract provides legal protection, in the event of any dispute, it should be born in mind that court settlements can be time consuming and expensive.

Useful reading

HM Treasury, *How to Appoint and Manage Advisers*, Technical Note #3, UK Government, 1999.

McAfee, P., *Incentives in Government Contracting*, University of Toronto Press, 1988.

Stockdale, A., *The politics of privatisation in Victoria* in **Privatisation International**, November 1999

9. Managing the PPI advisory services

Outline of this Module

What this Module does:

This Module describes the different roles that officials play within the overall process of managing advisors, ranging from those located in the PPI unit in the ministry in charge of privatization to officials in other ministries affected by the reform. The Module also suggests some institutional models for organizing officials.

Who should read this Module:

This Module should be read by officials involved in the overall management of the reform process, and particularly by officials involved in the management of advisors. Officials with responsibilities for setting the overall strategy for PPI reform and those with responsibilities for implementing that reform will need to be aware of the alternative arrangements that available for managing advisors.

The introduction of PPI is likely to require some internal reorganization of the government institutions to reflect the reform. Although this module is primarily concerned with the managing of advisory services for PPI, rather than the management of the PPI process itself, the two matters are strongly related.

This Module addresses four aspects of management of the PPI process. Section 9.1 discusses political structure for co-ordination and communication. Section 9.2 covers the institutional structure for managing the overall process from policy formulation to contract award and through to contract management. Sections 9.3 and 9.4 cover the management of contracts with advisors. Finally, section 9.5 discusses how the performance of advisors can be monitored.

9.1 The reform process needs a structure for political management

A prerequisite for successful PPI is agreement within government over the objectives of the reform and the steps that need to be taken. Many PPI programs have implications far beyond the interests of the immediate sponsor or line ministry (i.e. ministry with a responsibility for a specific sector). Processes are needed to resolve conflicts over reform objectives and mechanisms should they arise. They need to balance adequate political control with rapid decision making. They will need to be based on cabinet, and ministerial committees below cabinet level.

- **Cabinet** Major PPI programs may be of sufficient importance to warrant cabinet consideration. Cabinet processes will differ among countries. A possible approach is for cabinet to consider and endorse the major policy decision that initiates a reform, and legislation to support the reform. Where a major transaction is involved, cabinet should also be informed of the outcome. The timetable for cabinet consideration will have implications for timetables for final outputs by relevant advisors.

- **Ministerial or cabinet committees** Day-to-day management of a major reform will raise issues of sufficient importance to require ministerial consultation and decision but too detailed for full cabinet consideration. Some formalized structure will be needed for the key ministers involved to consult and reach a decision. Cabinet may formally delegate decision making to those ministers, or may delegate a power to recommend and reserve final approval for specific decisions. The composition of a dedicated ministerial committee should involve the key ministers. To avoid substantial delays in making decisions, membership will probably have to be limited.

Public dissatisfaction with the implications of a PPI program can prevent reform. It is important that the government communicates its program to consumers and other stakeholders, and consults with them, to ensure public support.

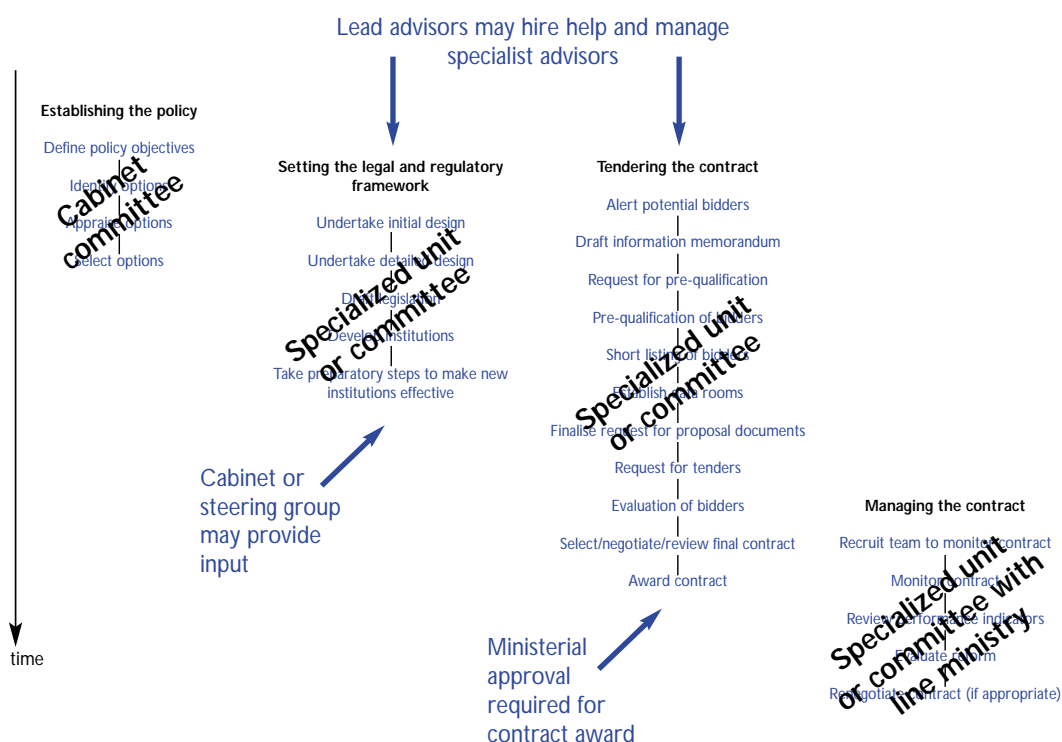
Most successful major reforms have relied on a key senior minister to act as a champion for reform. The appropriate approach will obviously differ from country to country. However, it is generally essential that communication is managed from one location. This becomes of increasing importance as a transaction nears its end. Investors will be very sensitive to political signals from the government. Only those ministers directly involved will be well informed of the most recent decisions and their implications for the wide group of stakeholders.

In some cases the government may have the necessary in-house resources to manage and organize the process of consultation and publicize the reforms. Where they do not, public relations advisors can offer advice about how to manage the relevant processes. (See Module 3 of *Volume I*).

In addition, the government needs to demonstrate commitment to the process. There are a number of ways in which it can signal commitment to the process of reform, including the hiring of competent private sector advisors and setting up autonomous reform management units. The announcement of major reforms in publications such as the *Wall Street Journal*, *The Economist* or *Financial Times* is another way of indicating government intent.

Figure 9-1 illustrates the potential parties that might be involved in managing the overall PPI process. Structures for managing the process of political reform – such as cabinet or ministerial committees - will be most likely to be active during the first stage of the PPI process, when policy is being formulated. However, as discussed, it is important that the key messages about the direction and intention of reform programmes are constantly reiterated and hence ministerial involvement will be required throughout subsequent stages of the process. Once the policy direction has been determined, cabinet or ministerial committees will play a less active role and may only be required to convene where decisions regarding changes in policy are required or to receive progress reports on reform and implementation. More generally, after the end of the policy formulation stage management of the PPI process will fall either to a pre-formed PPI unit (or some equivalent) or to a committee made of up officials for that particular initiative. They may receive some support from lead advisors.

Figure 9-1
Management of the PPI process



(Indicative arrangements for management of the PPI process)

Independent unit within government

The independence of the government agency managing the process will help to signal commitment (also see section 9.2). In particular, this will be more likely to hold if the unit:

- has a separate budget allocation that ensures funding over the entire period of the PPI process (i.e. not just for one project but for the reform program);
- is responsible directly to the highest levels of government, at least to the relevant minister and possibly to the head of the Treasury, Finance Ministry or to the head of state; and
- is situated away from other government departments providing it with the ability to operate independently.

Creation of a cabinet level authority in Bolivia

In Bolivia, a Ministry of Capitalization, headed up by a senior cabinet official, was established at the outset of the PPI program for the privatization of state-owned utilities, selected transport systems and mines. In a period of just three years, the Ministry oversaw the privatization of public enterprises in the telecommunications, electricity, railways, airlines, airports and hydrocarbon sectors. The process had strong political support at the highest levels: the Minister of Capitalization was understood to have 24 hour access to the President and to act with the authority of the presidency. Upon completion of the capitalization program, the Ministry was abolished.

Recommendation 9.1: Officials in the center of government should advise ministers on a structure for consultation and decision making. It will be important to formally define the role of cabinet, committees below cabinet, and individual ministers perhaps by presidential decree. It will also be important to communicate effectively with key stakeholders, and to centralize communications as a transaction proceeds.

9.2 Structures for official control

The extent to which reorganization is required depends upon the extent of the PPI reforms. Three broad approaches can be adopted:

- (1) *A centralized approach:* One model is to establish a unit to manage the PPI process located within a central department such as the finance ministry. The functions of such a unit could include:
 - coordination and communication of the reform program;
 - implementing major restructuring;
 - defining regulatory roles and establishing regulatory bodies;
 - preparing relevant legislation; and
 - managing major transactions.
- (2) *A decentralized approach:* Under a decentralised approach, the line ministry would be responsible for the functions outlined above. A dedicated unit would be created within the department for that purpose.
- (3) *A hybrid approach:* Two forms of hybrid approach could be considered. The first is where line ministries or agencies retain responsibility, but a central unit provides best practice advice and guidance on PPI implementation to other ministries. The second is where a dedicated unit is formed from one or more ministries. The ministries concerned would probably include at least the finance ministry and the main line ministry. Ministry and agency participation could reflect the involvement of key ministers.

There is no simple answer to the best approach (see Table 9-1). The main issues to consider when deciding on the structure are how best to use available skills in:

- restructuring and transaction;
- knowledge of the relevant sector; and
- managing relationships with key interests in the sector.

However, these issues can have different implications depending on the particular situation faced. For example, when restructuring and transaction skills are scarce, or when the government is embarking on an intensive program of reform, this is likely to argue for a greater degree of centralization.

Table 9-1
Advantages and disadvantages of PPI management approaches

Approach	Advantages	Disadvantages	Implications for managing advisors
Centralized	<p>Same department has control over whole PPI program—allowing it to understand the bigger picture and to learn from previous experience.</p> <p>Allows development of specialization in contract management.</p>	<p>Expertise within central department may not exist to oversee specialist aspects.</p> <p>Central department may have weaker relationship with key sector bodies.</p>	<p>May need to use sector specialists from line ministries to help manage advisory input. Other government specialists (e.g. economists, lawyers and engineers) will also be required.</p>
Decentralized	<p>Allows those in government who best understand the area or sector to manage the process, and the relationship with key interests.</p>	<p>Line ministry may lack skills in restructuring and transactions.</p> <p>May lose wider view of whole PPI program, and fail to learn from experience.</p>	<p>Mechanisms need to be put in place to ensure that advisors are not 'captured' by sectoral interests.</p>
Hybrid	<p>Allows combination of wider view of PPI program with understanding of needs specific to the department in question.</p>	<p>May create tension between the two departments who have opposing objectives. This may be reduced if the relevant ministers are working together.</p>	<p>Potential problems of lack of co-ordination between the two organisations. This may be confusing for the advisors.</p>

When knowledge of the relevant sector is weak, officials may develop contracts that create subsequent problems elsewhere in the sector. For example, toll road contracts frequently protect the developer against competing road developments. If the government attaches importance to particular future developments, this needs to be recognized in the contract design. When the transaction only affects part of a complex sector, this argues for a greater involvement of the relevant ministry, in order to avoid decisions being made which will foreclose subsequent options for further private sector participation in the future.

When relationships with key interests are neglected, reform can be blocked. It is important that relationships with unions, professional bodies, and other key groups in the sector are well managed. The most effective way of handling this will vary substantially from case to case.

Recommendation 9.2: Officials should take into account the implications of specific structures for managing the PPI process for the management of advisory services.

9.3 Organizational decisions

Once the location of the unit(s) is decided, ministers and/or senior officials will need to decide on the:

- appropriate number of staff;
- range of areas where expertise is required;
- need for input from external experts; and
- level of seniority of staff.

The answers to these questions will partly depend upon the scope of the PPI process. The introduction of a single service contract in a single sector would require little or no government reorganization. Full sectoral liberalization could require substantial policy work, new legislation, establishment of a regulator, management of the transactions and coordination of a range of government interests such as related sectors, industrial relations, finance, public works and the environment.

The staffing of the unit will also depend upon the extent to which external advisors are involved in the process of reform. Even where a large part of the process of managing the reform is contracted out to the private sector, there will still be a need for institutional structures to be established. In particular, officials will be required to:

- provide data;
- act as a contact point for the set of officials with whom the advisors will need to speak; and
- take decisions in circumstances where the advisors are faced with choices, or refer major decisions to ministers.

The establishing of a unit can also help facilitate knowledge transfer, particularly if, for example, the advisors work with officials on a frequent basis.

In determining the staffing needs for the unit, identifying the division of labor between officials and advisors provides a useful starting point. Based on this approach, Figure 9-2 and Figure 9-3 show the staff requirements involved in managing two illustrative PPI reforms involving a management contract and a full-scale divestiture.

Figure 9-2 illustrates indicative staffing levels required to organise a management contract. The figure shows that between one and four full time people might be required to manage the process from start to finish. This estimate is based on the assumption that a single (middle level) official would have responsibility for undertaking all of the internal tasks indicated. Additional input might be required from specialist and more senior staff for the purposes of tender evaluation and for contract negotiation. The responsibility for appointing and managing advisors might also fall to the same official, or alternatively the tasks of managing advisors might be allocated to a different person, depending upon the scale of advisory input. The input of administrative, secretarial and accounting/financial staff would be required on an occasional or part-time basis too.

Figure 9-3 illustrates the indicative staffing requirements for a unit managing an entire asset sale. It is envisaged that a much larger full-time core team of staff would be required to undertake the set of internal tasks indicated. This core team would be likely to comprise a project manager (usually a middle level official), a lawyer, an engineer and an economist. Part time input might also be required from staff with

publicity or public relations expertise, financial management and administration skills. A senior official (for example head of the privatization unit) would be required to direct the entire process, though on a strategic rather than a day-to-day basis.

Figure 9-2
Indicative staffing levels required to organize a management contract

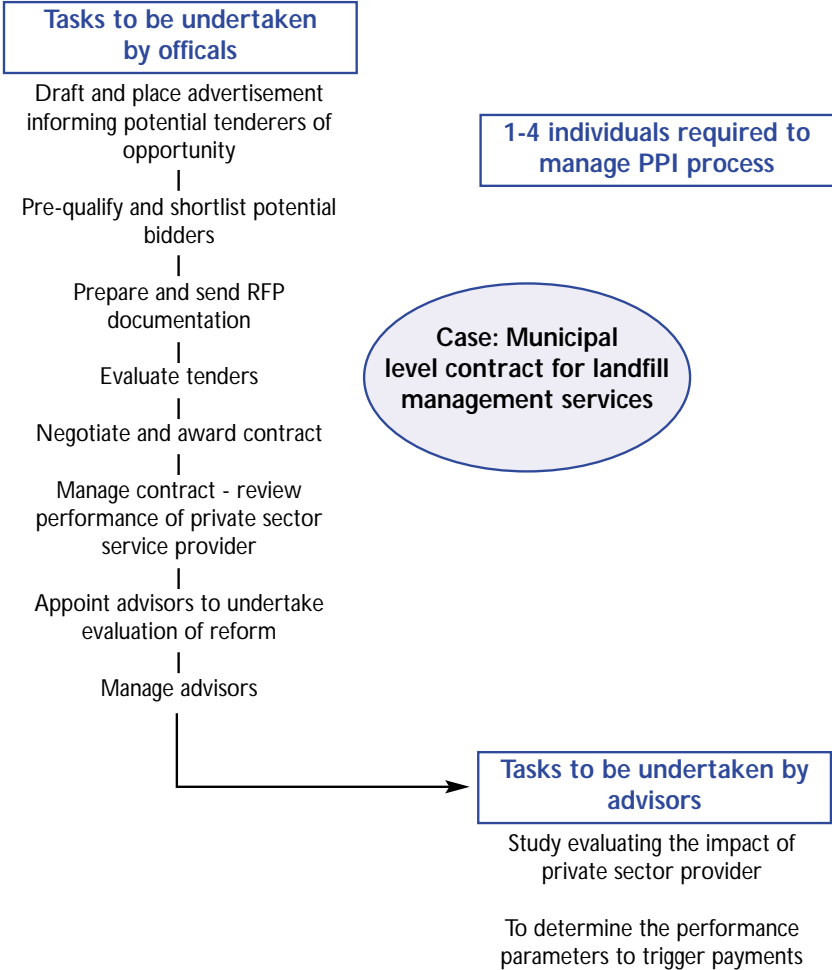
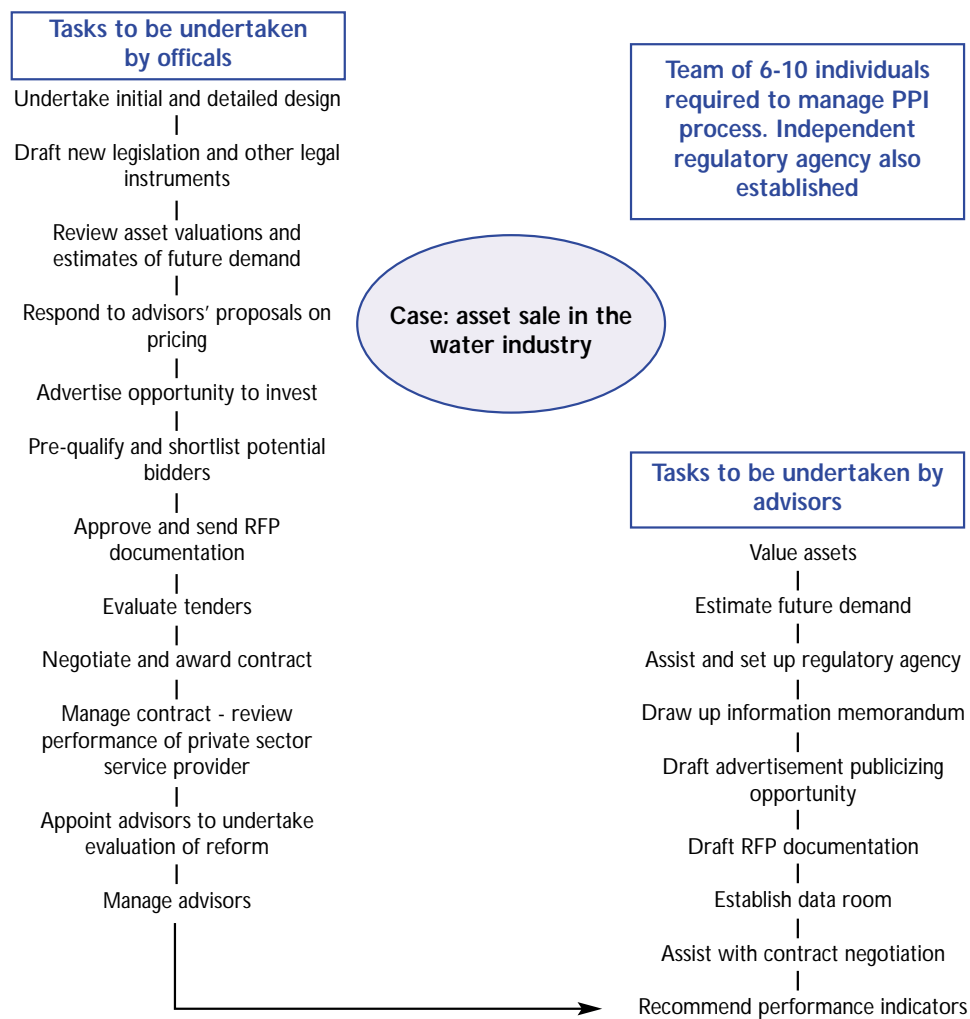


Figure 9-3
Indicative staffing levels required to organize an asset sale



Recommendation 9.3 Decisions about the role, structure and authority of the management unit should reflect the importance of the assignment.

9.4 Management of advisors

Once advisors have been appointed it is crucial that they are managed properly. It is preferable for the task of managing advisors to fall within the remit of the unit or officials involved in the overall PPI reform program or project. The following sections outline the differing roles that officials will play and the resources that will be required for the explicit purpose of managing PPI advisors.

9.4.1 Varying roles of officials

Managing advisors is an important task that can contribute significantly to the success or failure of the reforms. It is important that both the number and the seniority of officials required to manage advisors are not underestimated.

Given the close links between advisory services and the PPI reform program, it would be desirable for the officials managing the advisors to sit within the unit that is charged with managing the overall PPI reform program. Furthermore, payment for advisory services should come from or be authorized by the agency or unit responsible for the PPI project. This is important for the following reasons.

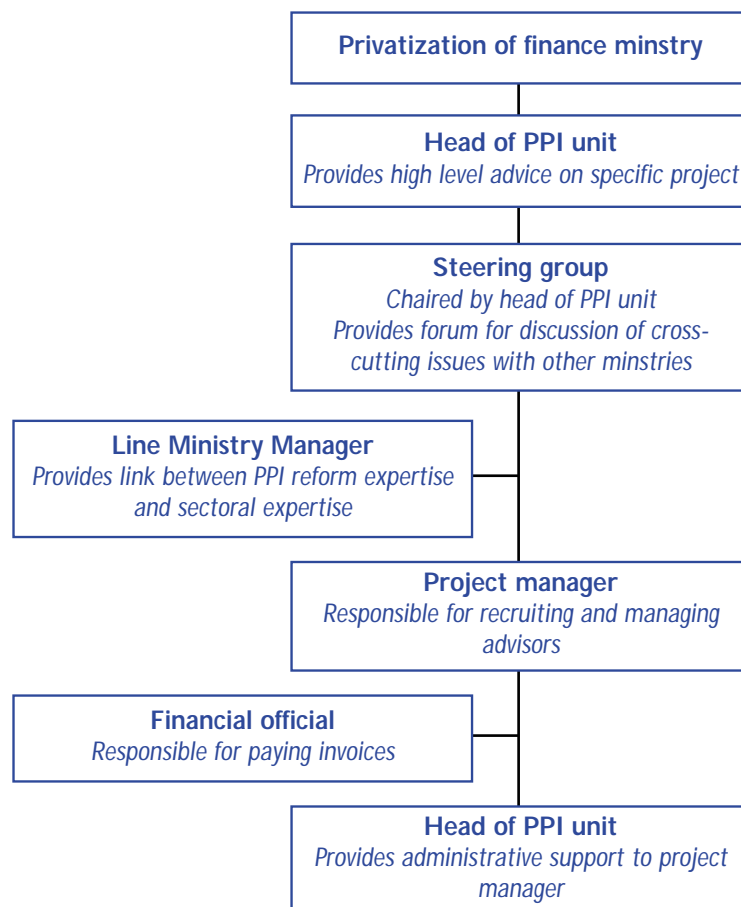
- If the finances for paying for advisory services came from a budget that the agency or unit did not control, payment for advisory services could be withheld for no reason.
- There may be no sense of urgency when paying for advice.
- The agency or unit will have incentives to ensure that they get the best value for money from their advisors.

Managing advisors is likely to require the involvement of a number of officials in varying capacities. At the very least, the different officials will be required to undertake the following roles:

- *Project management* – this is likely to fall to a middle level manager in the unit or line ministry.
- *Provision of senior advice* – this will be likely to fall to a senior level official, perhaps at the level of permanent secretary or minister.
- *Financial monitoring* – this will likely to fall to the finance division of the unit or line ministry.

Figure 9-4

Indicative roles of officials on PPI project



Recommendation 9.4: Management of advisors should be closely integrated with management of the reform program, ideally through colocation of the two activities within the same unit.

9.4.1.1 The project manager

A single person should act as the first point of contact for the advisors and have prime responsibility for the management of and communication with advisors. Depending on the type of contract signed (a single contract signed by a lead company within a consortium or individual contracts with specialist advisors) it may be appropriate to have:

- a single project manager;
- a lead project manager supported by individual project managers with responsibility for each contract with the specialist advisors; or
- a series of individual project managers reporting to an official with overall responsibility of the PPI process.

The project manager will be heavily involved in the management of advisors once they are appointed. It is desirable that they also play an important role in the process of appointment. In view of this, the range of tasks that the project manager will be likely to undertake includes the following:

- **Acting as the lead official** – to coordinate writing the TOR (see Module 4 in *Volume I*) that will eventually form the basis for part of the contract with the advisors and be the point of contact during the hiring process.
- **Coordinating with donors** – to serve as the day-to-day point of contact with lending agencies and trust funds involved with financial the technical assistance, if relevant. This requires detailed knowledge of the agencies' procurement guidelines and obligations for consulting services.
- **Agreeing a timetable with the advisors** – a condition for effective project management of advisors is establishing a feasible timetable over which the work is to be undertaken, together with an unambiguous list of deliverables or outputs.
- **Organizing the appointment of advisors** - as described in Module 7 (see section 7.2.4) this is likely to involve appointment of an evaluation committee.
- **Acting as a first point of contact with the advisors** – it is inevitable that issues will arise which require the advisors to seek clarification from government officials. These should be addressed to the project manager in the first instance. The project manager may then act as a conduit by putting the advisors in contact with other government officials.
- **Communicating the key changes to the advisors** – in a complex PPI process, the advisors' tasks will be affected by decisions that are taken elsewhere in government, perhaps by ministers. It is crucial that advisors are kept informed of these decisions and that others in government are aware of the suggestions being made by the advisors and their implications.
- **Approving payments, additional expenditures and monitoring project expenditure** – while the contract with advisors should make provisions for the sorts of additional expenditure that might be incurred, there may be a need for

the project manager to approve additional expenditures from time to time. Where advisors are not being paid on the basis of a lump sum contract, then the project manager may also be required to monitor the overall cost of advice.

- **Monitoring performance of advisors** – the project manager will be responsible for assuring to senior government and donors that the advisor is performing according to contract. In the case of the advisors' nonperformance the project manager will correct the situation through renegotiation or will notify senior officials if re-tendering appears to be required.

Depending upon the scale of the PPI project or program, the project may have a team of officials providing support. These advisors may be drawn from a wide range of ministries or agencies, providing regional, functional or sectoral expertise.

Recommendation 9.5: In most cases, the project manager should prepare TOR for the advisors, organize their appointment, and act as the first point of contact and channel for communications. The project manager should also control the timetable for deliverables and the budget.

9.4.1.2 Senior officials

Senior officials, although not directly involved in the day-to-day management of advisors, will, nevertheless, play an important role. The range of activities will involve:

- Justifying the need for advisors as part of the input into the reform process -this task may involve their early involvement, prior to embarking on the reform, if they need to secure extra funds from the government budget or from donors to pay for advisors.
- Negotiating with donor agencies – this task will need to be undertaken right at the start of the reform process. Where funds are secured, senior officials will have an additional role in ensuring that the funds are used in a way that is consistent with the agency's requirements.
- Making strategic decisions –about the PPI reform process which will impact on the range of tasks that are to be undertaken by advisors.
- Liaising with advisors - (usually via the project manager) if their input is required to take high level decisions as a result of the work undertaken by the advisors.
- Relaying the recommendations of advisors to ministers and other high level officials - to ensure that there is a continuous flow of information and that the relevant parties within government participate and sign on to the process.

9.4.1.3 Budget officers

While the project manager will play a role in monitoring and approving expenditures, they will not usually be the ones charged with processing and paying any invoices (although they will sometimes be the official receiving invoices in the first instance). Usually, there will be a need to designate an individual within the finance or accounting division of the administering agency or project implementation unit to ensure that payments are made to the advisors within a specified time. This individual must not relinquish payment unless the project manager is satisfied with the quality of the work.

The budget officer must also be made aware that the budget ought to reflect the timetable, quality and size of the project.

9.4.2 The management team's resource requirements

Managing advisors is a major task. This should be recognized when drawing up the job descriptions of those within the PPI management team. Sufficient time should be allocated to the task, even if more staff have to be recruited to ensure manageable workloads.

It is also important that recognition is given to the need for high caliber personnel to work with advisors. The managers of advisors may be required to absorb large amounts of technical information and to work to tight deadlines. It may be necessary to pay over-and-above normal civil service pay scales to ensure that suitably qualified officials are recruited and retained.

Section 9.3 outlined the bare minimum in terms of the different roles that officials will need to fulfil. Depending upon the form of PPI selected, a more complex team of officials might be required to manage advisors, perhaps cutting across conventional departmental boundaries or comprising staff with the relevant economic, financial, legal, technical and other skills.

Given the complexity and wide range of issues that officials might be required to address when managing advisors, wherever possible continuity of personnel should be ensured, even if this means keeping staff in positions for a longer duration than is normally practised.

In addition to people, the management team may also need to provide office space, bilingual support staff and communications facilities (telephones and internet/email access) to the advisors. It will be important to ensure that the advisors are located in government offices rather than in the offices of the utility, enterprise or entity that is subject to reform. This geographic separation of advisors from the entity concerned serves to reinforce real and perceived independence of the advisors.

Recommendation 9.6: Senior officials should ensure that the management team has adequate resources, and encourage staff continuity.

9.5 Monitoring advisors' performance

Once advisors have been appointed, it is important that they are not simply left to undertake the tasks set out in their TOR. In almost all circumstances there will be a need to monitor the advisors' performance, and to facilitate communication among the government officials charged with project management and the advisory team.

9.5.1 The structure for monitoring

There are several different approaches to monitoring the performance of advisors. The most appropriate will depend upon the size of the contract and the importance of the work that they are undertaking.

Steering group

The most common method of managing the work of advisors is through the appointment of a steering group to manage and monitor the progress and quality of outputs of advisors. This approach is particularly appropriate where a number of advisors with different skill sets have been appointed, or where a wide range of skills is required to judge whether the work of the advisors is of sufficient quality (e.g., during the initial and detailed design stages of the reform). It also provides an effective way of ensuring that all ministries affected by the reform have an opportunity to comment on the work of advisors. Where an evaluation committee has been established as part of the competitive tendering process, then this same group of people might be the best qualified to monitor the work of the advisors.

Specialized unit

Another common approach is the creation of a privatization unit, a semi-independent body headed up by a senior civil servant or non-government official that will oversee the entire PPI process. As emphasized above, it will be vital that this unit has direct access to senior members of government. Therefore, it is important to select as head of the organization someone with sufficient clout that they will have this access.

Lesotho Privatisation Unit

The Government of Lesotho has embarked on a wide ranging reform and privatization program covering everything from infrastructure to abattoirs. In order to coordinate the process, ensure stakeholder support and consistency across the many initiatives, the Government, created the semi-autonomous Privatisation Unit. The unit was officially placed under the Ministry of Finance but was located outside the main government offices and had independent funding from the World Bank.

In addition to considering the appropriate form of private sector participation in each of the industries, the Unit was also responsible for hiring advisors to set up the appropriate regulatory frameworks, draft the required outline legislation and undertake the implementation of the programs.

Stealth management

Where the amount of input from advisors is relatively small or specialized then it may not be cost-effective to establish an independent unit. The time and effort required to organize the group may well end up being greater than the value of the actual contract. If this is the case, then the project manager will need to devise mechanisms or procedures for keeping in touch with the service providers. Regular progress reports, either face to face or over the telephone, may offer one way of ensuring that both parties are kept informed.

In some cases it may be that the relevant expertise is not available within government to monitor the work of advisors. Where this arises, it would be desirable to appoint an external advisor (for example an academic or independent advisor) to enable the government to accurately evaluate the reports and recommendations from the external advisor.

Recommendation 9.7: The project manager should establish a management team that reflects the resources available and the complexity of the initiative.

9.5.2 Schedule management

The workplan submitted by the advisors should have a clear description of the outputs to be produced and the timetable under which they are to be submitted. If there are delays to the timetable, then it is important the project manager agrees to a revised timetable with the advisors (Module 4, in *Volume 1*, considers the timetable in more detail). The revised timetable needs to be feasible, and to coincide with the overall timetable for the PPI process. In some cases it may be necessary to revise the outputs to ensure they are feasible within the timetable.

The timetable should include interim outputs. This allows progress to be monitored and creates a series of small deadlines rather than one large one. Interim outputs may be short reports, workshops or presentations by the advisors. Alternatively, they may be drafts of the final report or reports on the progress of the financial or technical advisors in approaching bidders and valuing assets respectively. By structuring the work in this way, the government officials will minimize the risk that the final output fails (e.g., there is no private sector interest in the infrastructure in question) or the final output is unsuitable for the government's needs.

Recommendation 9.8: The project manager should ensure a timetable with phased outputs is agreed upon with advisors.

9.5.3 Importance of open communication

It is important to emphasize the need for interaction among all the stakeholders, including government officials, the advisors and the wider community affected by the reforms. Interaction with stakeholders through seminars and workshops helps to manage the timetable and may provide a series of performance indicators. In addition, they provide opportunities to present the current state of the advisory project to stakeholders and allow them to voice concerns or ask questions about the process which helps to ensure all stakeholders buy into the process. This interaction has the additional benefit of transferring knowledge about PPI to the wider community.

A more general process of consultation with the public can provide a way of generating support for reforms. Publishing consultation papers, and holding domestic road shows and information campaigns, informs stakeholders and can generate support. These may be focused at particular groups, for example at staff working in the companies to be exposed to the rigors of the private sector or consumers, or they may be more general campaigns aimed at generating popular support for the measures.

Recommendation 9.9: The project manager should ensure that there is interaction within government and with stakeholders. This structured communication may be facilitated by the PPI advisors through workshops, seminars, public relation campaigns and publications.

Useful reading

Treasury Taskforce website. *How to Manage the Delivery of Long Term PFI Contracts*. http://www.treasury-projects-taskforce.gov.uk/series_3/technote6/6tech_contents.html

Annex 1: Sample Terms of Reference

This Annex provides five sample terms of reference covering different sectors and different types of projects.

(1) Power sector regulation

Privatization of Acadia's Electricity System

Scope of Work for Regulatory Development and Tariff Modeling

Background

Acadia, a small state and former Portean colony with about 1.2 million inhabitants, has decided to privatize its electricity sector. The Department of Energy (DOE) is planning to sell its transmission and distribution assets to strategic, institutional and/or private investors. The new industry structure will allow for the development of IPPs in Acadia to sell electricity to the new utility and directly to major users. There are currently no generation assets in Acadia as the DOE purchases its power from a grid that is interconnected with bordering states. Insufficient power has resulted in load-shedding and pent up demand among Acadia's industrial, tourism and residential communities.

In advance of the transaction, the African Development Bank is managing several areas of technical assistance to strengthen the ability of the state government to conduct the privatization and regulate the privatized entity. Following a business and investment plan already conducted by the firm Sigmund & Pumpkin, the African Development Bank intends to retain a utility economics consulting firm to design an electricity tariff for Acadia and to design and help implement a new regulatory framework for the sector. The following proposal outlines the goal of the project, the purpose of the technical assistance, the work plan and deliverables that should be conducted as part of these studies as well as the bidding criteria that will be used to select the appropriate firm.

Goal of the Privatization

By allowing the private sector to invest in and manage the electric utility, the Department of Energy expects to increase the availability of affordable electricity to the domestic and industrial consumers of Acadia. Reliable access to electricity in turn will lead to increased opportunities for economic development, job creation, and poverty alleviation.

Purpose of the Technical Assistance

The two related objectives of this assignment are to establish a regulatory framework for the electricity sector and to design a sustainable and efficient tariff schedule. To support this objective, the consultant is expected to provide training to local counterparts, allowing them to develop the skills required to assist the future regulator and to share their experience on further power sector reform initiatives throughout the region.

Work Plan

The following section sets out the tasks to be undertaken by a utility consulting firm, in conjunction with an international lawyer, to implement a regulatory framework in

the context of the sector's imminent privatization and then to design a workable tariff for Acadia's electricity sector.

Phase I: Electricity Regulatory Design

In order to develop a regulatory framework that will allow the State of Acadia to monitor and negotiate with a private owner of Acadia's electricity system, the African Development Bank will retain a utility economics consulting firm, in conjunction with a utility lawyer and an Acadian economics consulting firm, to conduct the tasks outlined below:

- a) *Review of Acadia's Regulations (Weeks 1 to 3):* Review existing regulatory framework as it applies to the Department of Energy (DOE) including the responsibilities and relationships of relevant government entities at different levels, in order to identify the opportunities, issues and constraints that would/could arise with the introduction of private participation in the system/commercial company's activities;
- b) *Review of Regional Regulatory Frameworks (Weeks 1 to 3):* Review the most relevant regulatory arrangements applicable from other states in the region and other sectors in Acadia; identify lessons learned and evaluate the strengths and weaknesses of the approaches used; review other states' arrangements for multi-sectoral regulation;
- c) *Regulatory Needs Assessment (Weeks 2 to 6):* For the private participation transaction structure being developed by IFC, assess the need to modify each element of the existing regulatory framework;
- d) *IPP Licensing and Direct Sales Plan (Weeks 4 to 6):* Suggest a plan for allocating licenses for future IPPs with the State of Acadia, and the permissibility of these IPPs to contract with captive industrial buyers vis-à-vis selling to the grid;
- e) *Recommended Modifications (Weeks 5 to 7):* Work with the team of international and domestic lawyers to specify ways in which the regulatory framework should be modified to ensure the future viability of the sector, including what types of laws or decrees need to be passed, if any, and what form of new regulatory bodies need to be established; recommend an outline of modifications if framework is to be expanded to include other sectors;
- f) *Allocation of Regulatory Responsibilities and Institutional Design (Weeks 6-10):* The consultant will define any new regulatory functions and responsibilities and prepare a blueprint for how these would be allocated to existing and/or new entities. This includes defining the institutional arrangements for any new regulatory framework to perform effectively, including staffing, management, operating procedures, salary standards, job descriptions, equipment and other resources required by the regulatory body being established.
- g) *Time Schedule (Weeks 10-11):* Recommend approval steps and time frame necessary to implement the proposed framework of changes.

**Phase II: Regulatory Seminar and Tariff Design:
(Begins at completion of Phase I)**

- a) *Dissemination (Weeks 1 to 2):* Prepare and present findings on recommended regulatory structure and the nature of independent regulation to government officials in Acadia. This seminar will be developed in conjunction with the African Development Bank ESMAP and the PSDPP. Contribute findings to any presentation or article material being prepared by ESMAP/PSDPP as part of the African Development Bank's internal dissemination practices.
- b) *Future Training and TA Recommendations (Weeks 1 to 3):* Prepare recommendations on the requirements for technical assistance support and training for any proposed regulatory institution and how the costs for this and for the day-to-day operations of such institutions will be met. Provide clear indication of role of Acadian-counterparts in future training and regulatory development.
- c) *Review of Current Tariffs (Weeks 1 to 3):* Review existing and historic tariffs for different categories of customers including an assessment of the extent and reasons for previous non-payment of bills to determine the basis for tariff setting, any cross-subsidies and subsidies given, the relationship between tariffs and costs (marginal vs. average), the tariff adjustment process and treatment of financial and social objectives. In addition, prepare an assessment of the adequacy of existing tariffs to cover estimated costs and support future requirements;
- d) *Demand Forecasting (Weeks 2 to 4):* With the technical consultant, taking into account existing electricity demand forecasts, convert existing long-term demand forecasts under different sets of assumptions, into forecasts by category of customer and other agreed upon profiles;
- e) *Estimate Future Average Tariffs (Weeks 4 to 8):* Prepare a projection of a future average cost recovery tariff, according to the tariff structure recommended in the Regulatory component described below. The tariff schedules should be based upon the three capital expenditure scenarios (high, medium and low). This will be used to assist the Government of Acadia in selecting the optimal tariff/expenditure mix. In case industrial users are given the right to purchase directly from IPPs, the tariff model should allow for a sensitivity analysis to determine the impact on the average tariff.
- f) *Propose Tariff Schedules (Weeks 7 to 10):* Design a tariff schedule that reflects the different customer categories that will be served by the privatized utility. The tariff should take into consideration the poor's ability to pay, the impact of industrial users being served directly by IPPs, and must demonstrate the energy efficiency objectives of tariff setting. Review any elasticity analysis or willingness/ability to pay studies that have been conducted in Acadia to estimate the maximum tariff level consumers could theoretically bear. If such analysis is not available, discuss this issue with key stakeholders to estimate highest practicable level of tariff and feasible time schedule for increasing the tariff, if necessary. Prepare alternative tariff schedules that "soften" any increase in tariffs (by deferring returns, timing expansions, extending the duration of the license, or through any other means available) and present options to Government of Acadia.

- g) *Reconciliation of Recommendations with Other State Tariff Structures (Weeks 10 to 11):* Co-ordinate with on-going African Development Bank funded work on power sector tariff issues in Acadia and attempt to reconcile any inconsistency in outcomes. The consultant should also review the industry and agricultural tariff cost studies that the African Development Bank and the UK's DFID are jointly carrying out elsewhere in the region. If differences can not be reconciled, explain source of difference in written memo form to Government of Acadia and the African Development Bank team.
- h) *Review of Private Contract Document (As document is prepared - 1 week):* Review and comment on relevant sections of the draft private contract document especially as it relates to tariff setting, cross-subsidies, restrictions on immediate cost recovery (through ramped up tariffs, etc.) or any other issues that relate to the expected revenues of the business.

Deliverables

Phase I: Electricity Regulatory Design

Regulatory Review (Week 3):

Brief paper describing the status of the regulatory arrangements that exist in law and in practice in Acadia. Should include discussion of the national requirements for regulation as well as the precedence set in other states.

Regulatory Needs Assessment and IPP Licensing Plan (Week 6):

Description of regulatory or legislative changes required to modify each element of the existing regulatory framework, and specific treatment of impact of IPP policy as described in 4.2.d) above.

Proposed Regulatory Framework (Week 10):

A plan for implementing necessary changes to the regulatory framework in order to ensure the future viability of the sector should be proposed. This should also include the institutional recommendations described in 4.1.f).

Reconciliation of Recommendations with those elsewhere in the region (Week 12):

Memorandum explaining any differences between the proposed regulatory framework and tariff structure and those elsewhere in the region.

Phase II: Tariff Design (Begins after Phase I Completion)

Dissemination (Week 2):

Prepare and offer seminar as discussed in 4.2.a) above.

Future Training and TA Recommendations (Week 3):

Prepare recommendations on the requirements for technical assistance support and training for proposed regulator.

Tariff Structure Review (Week 4):

Brief paper describing the status of the current tariff in Acadia. Should include a discussion of any current willingness and ability to pay analysis conducted to date or the stakeholders' view on acceptable tariff levels.

Results of Tariff Model (Week 9):

The preliminary results of the tariff model should be presented with discussions of the average tariff and alternative "shapes" of the tariff over time.

Proposed Tariff Schedule (Week 10):

A full tariff schedule as discussed in 4.2 f) above should be presented.

Review of Private Contract Document (when contract/license is prepared):

Commentary on tariff-related sections of draft private contract document.

Duration

It is expected that the regulatory analyses will last about 10 weeks and the tariff work about another 11 weeks.

Resources

It is expected that the consulting firm will form a consortium with an Acadian firm. The lead international advisor will provide a project manager with several years experience in the privatization and regulation of electric utilities, as well as two to three staff with regulatory and institutional strengthening experience and one with proven tariff modeling capabilities. The Acadian firm should provide at least one manager and one analyst to work with the lead consultant. On the regulatory component, the consortium will be asked to work with an international utility lawyer, who will be appointed directly by the IFC/CFS. The lawyer will provide input on required changes to the laws of the State of Acadia in order to accommodate the recommendations made by the consulting firm.

Evaluation Criteria for Phase II Work

- Curriculum vitae of proposed staff: 30%
- Firm Experience in Electricity Privatization, Regulation and Tariff Design: 20%
- Relevant Firm Experience in the region: 15%
- Proposed Approach to Capacity Building of Local Counterparts to Provide Future Regulatory and Tariff Development Assistance: 10%
- Proposed Approach (understanding of and elaboration on above Work Plan): 15%
- Proposed Management Plan (time allocations and use of senior staff): 10%

Firm qualifications should include at least the following information: Client name and contact information, dates of assignment, approximate budget, names of staff involved, location of lead office, description of work completed.

Level of Effort

The consultancy is estimated to require approximately 190 persons-days for international consultants and 125 person-days for local consultants. The bidder should present a management plan that delineates, through bar charts, the expected time that each proposed consultant will spend on the project and how much of that time will be spent in Acadia. The bids should also contain fees for each consultant built up from his/her daily rates and the number of days each corresponding consultant is committed to the project. Traveling and other out-of-pocket expenses should be broken out by trip and by consultant. Any additional costs should be included and a total cost for fees and expenses should be provided.

(2) **Multimodal transport strategy**

Nayshinstate Infrastructure Summary Survey

Terms of Reference for Transport Specific Consulting Services

1. Background

1.1 Infrastructure Summary Survey

The Ministry of Transport and Public Works of the Republic of Nayshinstate, with support from the Inter-American Development Bank (IDB), is currently conducting an analysis, called an Infrastructure Summary Survey (ISS), of the current and potential role of the private sector in the Nayshinstate's infrastructure. While many regulatory, legal, financial and institutional issues surrounding private involvement in infrastructure are cross-sectoral, the ISS will address sector specific issues in power, water, telecommunications and transport.

The transport annex of the ISS sets out to summarize the current and potential role of the private sector in all modes of transportation in Nayshinstate. It will combine data collected by the IDB in its latest transport sector strategies with original analysis to be conducted under this consultancy. It is intended that analysis of the transport sectors will be completed and updated by the ISS team in the winter of 1997 supported by inputs from specialized consultants.

1.2 Definition of Transport Infrastructure

For the purposes of the Infrastructure Summary Surveys, transport infrastructure eligible for private sector participation is defined according to two major criteria:

- Permanence or immobility of the assets, reflecting the characteristics of a natural monopoly; and
- Reasonable potential for user fees that provide cost recovery of at least operations and maintenance costs, if not capital costs.

Because of the first criterion, ports and airports are analyzed in the ISS whereas shipping lines and airlines are not. Light and heavy rail systems will be analyzed in terms of both track and rolling stock since both components of the business are often owned, managed and operated by one institution. As a result of the second principle, toll roads and bridges in high volume industrial areas and on inter-city routes are considered potential sources of private sector participation, whereas rural and intra-urban roads are not.

1.3 Current PPI Arrangements for Transport in the Nayshinstate

To date, the Government of Nayshinstate has acted to involve the private sector in transport in several ways, including BOT projects, a consideration of the privatization of existing assets, franchises and joint-ventures, Build-Lease-Transfer contracts, and two or three concessions or long-term leases.

At first glance, this program seems comprehensive given the scope of alternative schemes being considered and the number of modes of transport that are involved.

However, when viewed project by project it is clear that relatively few initiatives have been implemented and of those underway, the relationship between the government and the private sector does not necessarily represent an optimal division of risk and responsibility.

2. Objectives of the ISS and the Consultancy

The objectives of the ISS are to assist the private sector to understand what has been accomplished to date in Nayshinstate as part of private sector's role in transport and utility service provision and what opportunities remain for future investment in infrastructure. The ISS will also raise crucial regulatory, legal, institutional and financial issues affecting infrastructure investment so that the Government of Nayshinstate can enact policies which encourage operational efficiency, financial responsibility and economic growth through greater private sector involvement in transport and utilities. The consultancy described herein will support this effort by assisting the ISS team in defining and analyzing the transport-specific opportunities for private sector participation in Nayshinstate and analyzing those issues which impact investment in all modes of transport.

3. Scope of Work

The transportation related analysis that is to be conducted by the consultant will be carried out under the direction of the transport specialist from the ISS team. Specific work steps will include the following:

3.1 *Analysis of the roles of municipalities and Local Government Units (LGUs) in implementing BOT and privatization schemes*

The following analysis should be conducted for the four or five most active LGUs or local municipalities

- Likelihood of LGU/local municipalities to decentralize themselves from port or airport sector agencies;
- Financial capability of local port or airport to exist as a stand-alone facility;
- Capacity of LGUs/municipality to conduct privatization: (1) Institutional structure of agencies responsible for privatization/greenfield development process for each mode of transport and description of human resource capability (staff sizes and educational backgrounds). (2) Regulatory responsibilities, if any, and capacity of those agencies to carry out regulatory functions, for each mode of transport.
- Existing projects outside of Woodland, the capital city, in all transport infrastructure sectors. Analysis should include: (1) description of type of investment (lease, concession, BOT, privatization, etc.); (2) bidding approach (unsolicited, closed or open "Swiss" challenge, or open competitive bidding); (3) breakdown of equity and financing including role of foreign participants; (4) obligations of investors; (5) risks or guarantees assumed by LGU or other public entities; (6) agreed upon tariff levels; and (7) role of national entity in negotiating or guaranteeing project.
- Relationship of four or five major non-Woodland municipalities/LGU's with corresponding national transport agencies and the impact of this relationship on the likelihood of decentralization.

3.2 *Review of laws and regulations impacting PSP in transport infrastructure*

The consultants will review all laws and decrees that govern PPI in the transport sector as a whole or in each mode of transport. The following matrix provides a basic guideline for the policy and legal issues that need to be addressed.

Point of Analysis \ Sector	Ports	Airports	Heavy Rail	Light Rail	Toll Roads	All Modes
Legal support for increased PSP in transport						
1. Laws and decrees applicable	1.	1.	1.	1.	1.	1.
2. Challenges to any proposed reforms	2.	2.	2.	2.	2.	2.
3. Political and societal support for reforms	3.	3.	3.	3.	3.	3.
4. Other likely or possible future policies	4.	4.	4.	4.	4.	4.
Objectives of PSP initiatives						
1. Primary legislation	1.	1.	1.	1.	1.	1.
2. Other public documents	2.	2.	2.	2.	2.	2.
3. Concerns of non-governmental stakeholders.	3.	3.	3.	3.	3.	3.

The consultants should pay particular attention to laws that restrict entry (for foreigners or any new investors), impact cost recovery or otherwise define tariffs, refer to commercial, political or exchange rate guarantees, or define what is an acceptable investment, either in existing assets or for greenfield projects.

3.3 *Mapping of institutional relations and processes for privatization*

Currently, the Ministry of Finance provides diagrams that map the BOT process in general as well as the privatization process for all sectors of the economy involved with PSD. These diagrams represent the generic de jure process, but do not describe the de facto experiences of bidders for projects in each sector. The consultant is asked to provide diagrams for each sector that demonstrate how the different government agencies and bidders interact, as well as the time schedule and procedures involved with bidding, project approval, selection of firms, and implementation.

3.4 *Impact of Right of Way issues on private investment opportunities in transport*

The consultant will review the Government's commitments to financing and executing Right of Way obligations for privately financed projects in toll roads, light and heavy rail as well as new ports and airports or expansions to existing facilities. This will include potential commitments from proposed projects such as the commuter rail initiative. The analysis will include:

- Review of existing laws and procedures involving involuntary resettlement and a comparison of actual practices with laws and procedures;
- A summary of those projects that are (1) under construction, (2) planned and (3) potential according to resettlement requirements (numbers of families per project; calculation of the costs).
- Description of the impact of Right of Way obligations on financial viability of projects according to (1) ability of Government to finance its commitments; (2) concerns of equity partners/financiers to back projects requiring large Government commitments to resettlement and property claims; and (3) reluctance of lending agencies (multilateral or bilateral) to support projects with debt or guarantees.

3.5 *Analysis of cost-recovery potential for the Nayshinstate's transport infrastructure*

The consultant will analyze historic and current financial information from the transport infrastructure SOEs to determine their ability to cover costs. The focus of the analysis should be on those areas which are currently causing a drain on the finances of the national budget but which could benefit from private sector involvement:

- *Airports*: The financial performance of the major international airports. Focus on sources of revenue (terminal rents, landing fees, parking, warehousing, concessions) and major cost categories, including the status of outstanding investments;
- *Railways*: The financial performance of the rail operator, broken out by cargo services, passenger services, land rentals and non-core businesses;
- *Ports*: Financial performance of the operator, broken out, if possible, by: (1) domestic general cargo/container facilities, (2) international general cargo/container facilities, (3) bulk handling facilities;
- *Toll Roads*: Percentage of Department of Transport's budget and absolute cost of funding maintenance, rehabilitation and expansion of those roads which are being considered for private toll operations; changes in the cost of maintaining the franchises as a result of toll joint-ventures; impact on national and local budgets as a result of future BOT highway, bridge and toll road joint ventures.

4. Duration and Level of Effort

The duration of the project will be approximately 14 weeks from mobilization of the consultants and it expected to begin within 2 weeks of the contract signature.

The schedule for the work will be negotiated with the consultant, but is expected to include approximately:

- 3 person weeks in the field over a 2 week duration to interview and survey private sector investors and relevant government officials;
- 3 to 4 person weeks of desk work to conduct necessary analysis over a 2 week duration; and
- 1 person week to complete analysis and present written conclusions to IDB ISS team:

5. Selection Criteria

Firms/consortia are requested to submit both a technical and financial proposals. The selection method will be based on both cost and quality where the final score will be a weighted average of the technical and financial proposal scores. A weight of 90% will be attached to the technical proposal and 10% attached to the financial proposal.

6. Submission Information

The original and five copies of the technical and financial proposals should be sent to the following address:

The Ministry of Transport and Public Works
Lender Road
Nayshinstate.

All envelopes should be marked for the attention of the Multimodal Transport Strategy unit and should arrive by 1300 hrs, 19th September 2001.

(3) Water regulation

Terms of Reference

*Regulatory Framework for Private Participation in Water and Sanitation
Ceteria Water Sector*

1. Background

The South Pacific Bank for Reconstruction and Development has prepared a technical assistance (TA) loan (with a small emergency investment component) to be co-financed by the South Pacific Development Bank. The purpose of the loan is to:

- strengthen the recently established water sector regulatory framework;
- improve the managerial and operational efficiency of Ceteria Water And Sewerage Company (WASCO), the public water utility, through private sector participation; and
- improve water supply reliability in the North and the Damsforth system in the South through urgently needed capital investments in the short term, and through the eventual concessioning of the water utility.

Despite years of efforts to improve the performance of the public water company through conventional institutional strengthening programs and twinning arrangements, the water company continues to perform poorly, with unreliable supply of water, low coverage of sewerage, poor financial performance, and low level of capital investment. Considering the large investment backlog and poor operating performance of WASCO, the Government of Ceteria has decided to introduce private sector participation in the water sector through a concession agreement.

In March 1999, the Government of Ceteria passed into law The Water & Sewerage Act which redefines the roles and responsibilities of the public water utility (WASCO) and prescribes a regulatory and operating framework for the development of Ceteria's water sector. While the Water & Sewerage Act is a positive step forward in creating a new operating and regulatory environment for water supply and sewerage services, some ambiguity and inconsistencies will remain until the Law is further defined and the regulatory institutions strengthened. Concerns over the Act's treatment of key regulatory and policy concerns include, but are not limited to, the following themes:

- *Regulatory independence:* The current Act does not include necessary tools for distancing policy makers from the RWSS, and does not provide a secure funding source or access to technical support for regulatory decisions.
- *Policy setting responsibility:* The Act mixes responsibility for sectoral policy making among the regulator, the government and the operator.
- *Environmental and health-related regulatory responsibilities:* Under the current arrangements, the RWSS may be required to assume water resource management responsibilities while responsibility for adherence to water quality standards remains unclear;

- *Concessioning arrangement:* The Act does not define the future role of WASCO, its relationship to the private operator, the governmental signatory of a concession agreement or the principles of private sector provision; and
- *Licensing regime:* The Act does not provide a clear process for the provision of licenses for water sector operators.

2. Objective

The Objective of the consultant's services is to strengthen Ceteria's regulatory framework in order to facilitate significant and sustainable private sector participation in the water and sewerage sector while protecting the interests of Ceteria's consumers. This objective will be achieved through implementation of the following tasks:

- (a) A review of all relevant laws, statutes, regulations, and licenses related to the respective roles and responsibilities of the Government of Ceteria, the Regulator of Water & Sewerage Services (RWSS) and the Water and Sewerage Company (WASCO), in the interim period before the concession as well as for the period of private sector operation.;
- (b) The design of institutional structures and arrangements that clarify the appropriate roles, responsibilities, staffing needs, funding sources, and legal, statutory, or licensing requirements of the regulator (RWSS), a secretariat (or advisory council) to support the regulator, and the current and future water operator.
- (c) Presentation to the Government of Ceteria describing the legislative and/or administrative measures needed to formalize the regulatory institutions and arrangements that will provide a secure investment environment for the future operator and a fair system of protection for all consumers. This would include recommendations on the need to repeal, amend, expand, clarify and/or modify current primary and enabling legislation, regulations, statutes and licenses;
- (d) Drafting of all laws, regulations, statutes or licenses required to legitimize the appropriate regulatory institutions and arrangements;
- (e) Design of a training program for regulators and secretariat staff that will allow them to fulfill their responsibilities once the concessionaire is in place.

3. Scope Of Work

3.1 Review Of Current Regulatory Framework

The consultants will conduct a thorough review of all relevant laws, regulations, statutes and licenses pertaining to regulation, policy making, operations and private sector participation through the concessioning of WASCO. The review will be carried out in consultation with the legal representative from the Attorney General's Office and the Project Management Unit. The areas that require particular attention include, but are not limited to, the following:

3.1.1 Institutional Roles and Responsibilities:

Regulator of Water & Sewerage Services(RWSS), the current operating company (WASCO), future operating company/companies, and any relevant government ministries. Issues of particular concern include:

- Regulatory independence: The consultant will review the legal conditions under which the RWSS commissioners are selected, appointed, removed from office, provided with funding and given access to technical support.
- Responsibility for sector-wide policy making: While the Water Act establishes the RWSS as a regulator, it also seems to grant the RWSS an unusual authority to set sector-wide policies¹⁴. The consultant should review the allocation of policy-setting authorities among the RWSS, Ministry, and other relevant government bodies according to the Water and Sewerage Act and other relative legislation in Ceteria.
- Responsibility for introducing private sector: The Water Act may be interpreted as granting the RWSS decision-making authority regarding the introduction of private sector participation in water supply and sewerage services¹⁵. The Consultant should clarify the RWSS's role in initiating private sector participation. The Consultant should also clarify if a separate license from the RWSS is required for WASCO's sub-licensees or for the new operator.
- Responsibility for formulation of tariff formula, level and structure: The Consultant should clarify the respective roles of the RWSS, the government and the operator in defining the nation's tariff level, formula and structure¹⁶.
- Service obligation: The Consultant should clarify the specific service obligations of WASCO¹⁷ as well as the obligations of the future operator;
- Water resource management and conservation: The Consultant should clarify the allocation of roles and responsibilities for allocating and regulating water resources and setting conservation standards including the government, the regulator and the operating company's responsibility in conserving, redistributing or otherwise augmenting water resources¹⁸;
- Quality of service: The consultant should clarify the current allocation of responsibilities for setting water quality standards, and for monitoring, reporting and enforcing those standards.

3.1.2 Identification of Obstacles for PSP:

The Consultant will review Ceteria's relevant laws and statutes (including the Public Utilities Act, the Water and Sewerage Act of 1999, and any relevant corporation, investment, property or tax laws or statutes) and identify any provisions or gaps that may present obstacles to the successful concessioning of WASCO.

¹⁴ See Articles 3 and 4.

¹⁵ See Articles 6 and 35.

¹⁶ See Articles 4 (b) and 32.

¹⁷ See Article 13.

¹⁸ See Article 9 (1)(2)

3.1.3 Review of Interim License for the Operations of WASCO:

The Consultant will review the interim license for WASCO's operations to determine any flaws or gaps which could be remedied quickly and to identify any obstacles the interim license may create for the future concessioning program.

3.2 Institutional Design of the Regulator and Definition of Roles and Responsibilities

3.2.2 Definition of the Regulatory Roles and Responsibilities:

The Consultant will define essential roles and responsibility of the regulatory bodies necessary for successful oversight of the water sector. The Consultant should recommend the RWSS's responsibilities with regard to:

- Determining and monitoring the operator's tariff setting procedure;
- Setting, advising or responding to policy makers on appropriate performance criteria including service coverage, quality standards, environmental standards and customer relations;
- Collecting information and monitoring the operator's performance;
- Imposing sanctions for non-performance;
- Arbitrating disputes that may arise between the operator and its customers;
- Allocating water resources: The Consultant should recommend amendments to current practice where the RWSS issues water use licenses for those abstracting water within control areas while no licenses are required for abstraction of water outside of controlled area.

3.2.3 Design of the Regulator's Organizational Structure:

The Consultant will define the organizational structure of the RWSS and related bodies to ensure its independence and accountability in performing the responsibilities determined in the task above. The Consultant should make specific recommendations on:

- Appropriate use of a secretariat or advisory body to provide commissioners with support in all technical matters;
- Funding sources, i.e., the options for funding the work of RWSS through license fee paid operator and/or direct levies on customers. This should include estimates for the budget requirements of the RWSS and its secretariat;
- Appointment criteria based on professional expertise and absence of conflict of interest;
- Job descriptions for each member of the Regulator and its Secretariat;
- Composition of the Regulator and its Secretariat;
- Fixed and staggered tenures and transparent rules on the removal of regulators;
- Competitive salaries for Secretariat;
- Transparent and timely decision making processes;
- Consultation procedures such as public hearings with relevant stakeholders;
- Dispute resolution mechanisms;
- Independent audits of the RWSS's annual activities.

The institutional design should be inclusive of the potential for eventually transferring some degree of regulatory responsibility—particularly that assigned to the Secretariat—to a regional regulatory body. The analysis for the potential of regional regulation should include the need for power regulation, and the potential for multi-sectoral regulation at the regional level.

3.3 Recommendations To Improve Current Legal And Regulatory Framework

3.3.1 Identifying the Mechanisms for Regulatory Strengthening:

The consultant will provide recommendations that define i) need for changes to primary legislation; ii) the extent that decrees, statutes or implementing rules and regulations can be used to fill the gaps in the current regulatory structure; and iii) the extent to which clarifications to the framework can be placed inside of licenses, concessions and other contractual tools. In establishing such principles, the Consultant should confer with the legal representative from the Attorney General's Office and consider the current capacity within the relevant ministries and the RWSS to interpret broad principles.

3.3.2 Presentation to Government on Recommended Changes:

Once the review and the institutional design work have been completed, the consultants should present the full recommendations to changes in the regulatory structure to the Government. In order to make perfectly clear the degree to which different tools can be used to correct the regulatory framework, presentation should include summarizing matrices such as the one below:

	Organization and Responsibilities of Current WASCO	Organization and Responsibilities of Future WASCO	Organization and Responsibilities of RWSS	Organization and Responsibilities of Government Agencies	Other Institutions
New primary legislation					
Legislative amendments					
Regulations					
Licenses					
Others Mechanisms					

The presentation must include an analysis of how the recommended regulatory structure could be transferred to a regional body with particular attention to the need for minimizing further legal or statutory changes.

3.4 Drafting of Changes to Regulatory Framework

3.3.3 Once the government has agreed on the approach recommended in the Consultant's Presentation, the Consultant will begin drafting all necessary documents, beginning with primary legislation (if required), including:

- Draft necessary amendments to the Water and Sewerage Act of 1999 as well as any other primary legislation;
- Draft necessary implementing rules and regulations to define the roles and responsibilities of the regulator, the operator and other relevant agencies; and
- Outline the main articles of the new operating license and concession agreement for the future concessionaire.

3.5 Training Needs Assessment

3.5.1 Assessment of Skill Requirement and Recommendation on Training Options:

The Consultant will determine the skills required to meet the outputs necessary for the regulatory agency; assess what training is required to develop those skills; and provide a series of options for delivering the training.

Since staff are not yet in place for the agency, it is impossible to know exactly what training each staff member will require. Consequently, the consultant should develop a framework that will allow the agency staff to assess their existing skills against the agency's needs and then consider the options for meeting any skills gap.

Options for delivering the training should include international courses, regional and local training plus tailored in-house courses and on-the-job training. Any option should be assessed in terms of the cost-benefit trade-off provided so that agency staff can make appropriate decisions about the most cost-effective way of meeting the skills gap.

3.6 Workshops in Ceteria

3.6.2 Workshop for Government and Commissioners:

The Consultant will prepare and present findings on the recommended regulatory structure and the nature of independent and accountable regulation and discuss the training requirements and options with the members of the RWSS and other relevant government officials of Ceteria.

4 Outputs

The Technical Assistance program described above will result in the following outputs:

4.1 Inception Report on the Current Roles and Responsibilities in Ceteria's Water Sector.

4.2 Institutional Design Recommendations

4.3 Presentation to Government on Recommended Changes to Regulatory Framework

4.4 Draft Changes to the Regulatory Framework:

- Draft Amendments to the Water and Sewerage Act of 1999 and any other primary legislation;
- Draft Implementing Rules and Regulations required to establish the recommended regulatory framework;
- Outline of License and Concession Agreements

4.5 Report on Training Needs and Options for Regulatory Skill Development: This report will consist of the following:

- Analysis on the skill requirements and training need for the RWSS and its Secretariat; and
- Suggestion on appropriate training options for these bodies.

4.4 Workshops in Ceteria:

The Consultant will hold a workshops in Ceteria for commissioners, government officials, key WASCO staff and potential Secretariat staff to present and discuss:

- The role and activities of independent and accountable regulators, skill requirements for such regulation, and available training options; and
- Necessary legislative and administrative changes to ensure the regulators' independence and accountability, as well as the process for transferring the regime to regional regulation.

5 Management Plan

5.1 Qualifications

The assignment is for a team led by a senior utility regulation specialist supported by an international lawyer(s) expert in world standards in water laws and regulations, a local lawyer(s) familiar with workings of Ceteria's legal system and supporting regulatory analyst(s). The regulation specialist should have extensive experiences with designing infrastructure regulatory systems and be familiar with best practices for institutional arrangements for water resource management and the economic regulation of potable water supply. The international lawyer should have expertise in water-related laws. The local lawyers should be familiar with the constitution, administrative laws, and other laws of Ceteria relevant to this assignment.

5.2 Levels of Effort

The consultancy is estimated to require approximately 59 person/weeks in total, including 21 person-weeks for senior and junior regulatory specialists, 16 person-weeks for international lawyers, 16 person-weeks for local lawyers, and 6 person-weeks for analytical support and training specialists.

5.3 Duration

It is expected that the consultancy will last about 16 weeks.

6 Proposal structure and scoring criteria

6.1 Type of Contract and Budget

As mentioned in the attached Data Sheet, the type of contract will be a Fixed Budget. The maximum budget allowed (including all fees, expenses, taxes and any other cost to the consultant) will be US\$xxxxx. The financial proposal from the firm with the highest scoring technical proposal will be opened at a Public Opening (date to be announced). If the financial proposal has been calculated without error (rates, levels of effort, fees, expenses, per diem, taxes, etc.) and does not exceed the dollar amount above, then that firm will be invited to enter into negotiations with the Government of Ceteria to carryout the consultancy.

6.2 *Technical Proposal*

The Technical Proposal should contain:

- a brief background on the proposed consulting team specifying the degree to which the firms and individuals have collaborated on past assignments;
- a proposed approach or work plan that elaborates and/or improves upon the approach and outline provided in these ToR;
- a management plan that relates the team members to the tasks to be performed and describes each team member's planned contribution to the analysis in person/days in Ceteria and at home and according to task;
- firm qualifications of each corporate member of the consortium;
- full cv's of each individual consultant who is proposed;
- Gantt or bar charts detailing the duration of each task and the involvement of individuals over time.

6.3 *Financial Proposal*

The Financial Proposal should contain:

- Fee breakdown: Daily rates and numbers of days, by task, of each member of the consulting team
- Expenses: All meals, hotel, travel, incidentals, communication, production, facilities and other expenses anticipated for the project;
- Calculation of total cost.

6.4 *Threshold for opening of Technical bid*

Technical Threshold to Reach Opening of Financial Proposal: 80 points

6.5 *Proposal evaluation*

The technical proposal will be scored as follows.

- Proposed Approach (value added of work plan, originality)
15 points (15%)
- Proposed Management Plan (levels of effort, use of key staff, field time, previous experiences working as a team, appropriateness of assignments)
10 points (10%)
- Firm Experience
25 points (25%) of which:
 - Utility/water regulation, legal development 15 points (15%)
 - Small scale systems regulation 5 points (5%)
 - South Pacific experiences 5 points (5%)
- Curriculum Vitae Of Proposed Staff
50 points (50%) of which:
 - Regulatory specialist 20 points (20%)
 - International lawyer 20 points (20%)
 - Local lawyer 10 points (10%)

Consultants will be judged according to their knowledge and expertise in development of a regulatory framework for private participation in water sector; in drafting legislation and administrative orders; in institutional arrangements for water

resource management and water supply; in sectoral and regional regulation; and in training needs assessment.

As a whole, the team will also be judged according to its combined experience and complementary skills in conducting thorough analysis such as that described in these Terms of Reference. This will allow one team member's functional skills or regional experience in the South Pacific, for example, to compensate for other team members who may offer different skills.

Consultants are asked to provide references for all past projects listed on curriculum vitae and in the statement of firm qualifications. All firm qualifications should be seven years old or less.

6.6 Submission information

The original and 3 copies of the technical proposal as well as the original and 3 copies of the financial proposal should be sent in separate envelopes to the following address:
Ministry of Finance and Planning
Office of State Reform
12 Dryer Lane
North Island
Republic of Ceteria
Attention: Water regulatory proposal

Proposals must arrive at the Office of State Reform no later than 1500 hours on 1 December 2001.

(4) Power sector reform

Ghoreit: Power Sector Restructuring and PSP Strategy

Preparation of Restructuring & Privatization

Implementation Plan

Terms of Reference for Consultancy Services

Introduction

The Government of Ghoreit is undertaking the structural reform and privatization of its utilities sectors. Substantial reforms have been implemented in telecommunications, with the introduction of a Second National Operator and the impending privatization of the incumbent operator. The next sector due for comprehensive reform is electricity. The Government has been considering options for reform and is now seeking a consulting firm to recommend a specific restructuring program and implementation plan.

Objectives of this Engagement

The goal of this engagement is to develop a realistic privatization Implementation Plan that outlines the most viable long-term structure for Ghoreit's electricity sector. The plan will be based upon a thorough review of existing documentation, meetings with key stakeholders within Ghoreit, site visits to review existing and future facilities, an investors' survey that takes into consideration the market's level of interest and preferred structure, and the international experience of the consulting firm. The Implementation Plan will be presented, discussed, accepted or revised, and approved at a conference in London that includes senior Ghoreitian officials. Following the conference, the consultants will conduct de-briefing meetings with stakeholders in Ghoreit and will prepare terms of reference for other areas of technical assistance and transaction support.

Since the over-all objective of the reform program is to expand affordable and reliable electricity service to Ghoreit's citizenry, the consultancy must take into consideration the implications of the dispersed population and rural communities of Ghoreit. In this context, the right of the state as sole electricity provider, even outside of the main cities, must be considered as part of the privatization process.

Electricity Sector Background

The existing sector is dominated by the state-owned utility, the Ghoreitian Electricity Board (GEB). The vast bulk of the power is provided by a single dam that was built over fifty years ago with a current capacity of 400 MW. The financial and operational performance of GEB has been poor. Current problems include high system losses, low revenue collection rates, high accounts receivable, and poor quality service. Only about 10 percent of Ghoreit's 20 million citizens has access to electricity.

GEB's poor performance, combined with the policy preference for private provision of infrastructure services, has led the Government to examine options for reform, a process which started five years ago.

In addition, the Government has been negotiating with a number of private developers to establish new dams as independent power projects. The technical, financial and environmental analysis and documentation negotiations are at various stages of development.

Scope and Organization of Work

The work will be conducted in several steps outlined below:

I. Work Plan

Step 1. Ghoreit (Week 1)

Hold discussions with Government staff to discuss prioritization of issues. Focus on determining what is the optimal long-term structure of the sector and what role the private sector can play in the delivery of electricity. Privatization Action Plan will address the following key issues:

- Sequencing of privatization, for commercial operations, transmission, and existing generation
- *Strategy for future generation expansion, by IPPs and at existing sites*
- Costs and benefits of disaggregation
- Likely impact on tariffs of privatization and sectoral restructuring options
- Best approach to privatization for each component or bundled portion of the system (leases, concessions, sale of assets, BOTs)

Step 2. Home office (Week 1)

Review key sectoral documents prior to departure including

- Laws and regulations
- Existing Strategic Plan
- Reform Options Paper
- Load Forecasts and other available technical papers

By middle of first week, leave for Ghoreit

Step 3. Home office (Weeks 1-3)

Conduct Investors' Survey

- Approximately 20 international strategic investors to be interviewed
- 3 page background sheet on sector to be prepared by consultant
- 1 page questionnaire and background sheet to be faxed to investors
- Questions will focus on:
 - Level of interest in investing over-all
 - Level of interest in investing under different industry structures
 - Level of interest in investing given different approach
- Responses shall be tallied, analyzed and presented in Steps 7 & 8.

Step 4. Ghoreit (Weeks 1 - 3)

Interview stakeholders and other consultants

Step 5. Ghoreit (Weeks 2 - 3)

Review facilities

- Existing generating, dispatch and selected distribution sites
- Likely locations for future generating capacity

Step 6. Ghoreit (Weeks 3 - 4)

Review status of current reform initiatives and negotiations

Step 7. Home office (Weeks 4 - 5)

Prepare recommendations in presentation format that address the alternatives available for private sector participation in Ghoreit's electricity sector

Step 8. London or Ghoreit (end Week 5)

Deliver presentation to senior government officials and WB attendees (See Outputs (1) below)

Step 9. London or Ghoreit (Week 6)

Participate in workshop to discuss/agree upon recommended approach

Step 10. Ghoreit (Week 6)

Draw up Implementation Plan for agreed upon approach (See Outputs (2) below)

Step 11. Ghoreit (Week 7-8)

Hold follow-up stake holder meetings to present Implementation Plan and build consensus

Step 12. Home office (Week 6-8)

Draft TORs for next set of technical studies and privatization support (See Outputs (3) below)

Outputs

The key outputs will be (1) the presentation in London on the Recommended Sector Structure and Approach to Privatization; (2) the follow-up Implementation Plan; and (3) the draft Terms of Reference.

(1) Recommended Sector Structure and Approach to Privatization

This presentation will consist of the following components:

- Results of sector review, including:
 - a stakeholders' analysis
 - observations and conclusions from document review
 - observations and conclusions from site visits

- Results of Investors' Survey
- Recommended industry structure
- Recommended approach to privatization

(2) Implementation Plan

The consultant will be responsible for coordinating the outcome from the meetings in London and producing a short and practicable Implementation Plan, that includes the modifications (if any) to their recommended industry structure and approach to privatization, as well as a time schedule for implementation and a matrix of responsibilities.

(3) Draft Terms of Reference

In order to assist the Government to continue with the process of privatization, the consultant will be asked to produce draft terms of reference for the next phases of work. These components will be defined by the approved recommendations and may be grouped differently, but are likely to include the following components:

- Privatization Implementation Consultancy
 - Asset valuations
 - Likely average tariff modeling under different scenarios
 - Drafting of legal changes and contractual documents
 - Transaction support

Aside from these physical outputs, the consultant will be expected to conduct an investor's survey, a number of stakeholder meetings, and to facilitate the finalization of the Implementation Plan as described in the Work Plan above.

Working Arrangements

The consultants will be employed by the Enterprise Development Project and report to the Director of the Privatisation Agency within the Ministry of Finance. The consultant will work closely with the Power Sector Reform team, which is comprised of individuals from the Ministries of Finance, Natural Resources and other key stakeholders. The Privatisation Agency will ensure that the consultant has all necessary information, contacts and meetings needed to perform the assignment.

Level of Effort

Due to the urgent nature of this work, it is envisaged that the small team of consultants with hands-on experience in electricity sector restructuring and privatization will work on this project from mid-June to mid-August 1998. Over the course of 8 to 9 weeks, the contract will provide for approximately 21 man-weeks of consultancy for three individuals. The two senior members of the team will spend considerable time in Ghoreit.

The team should include,

- Project Director with expertise in electricity sector planning, restructuring and privatization
- Senior Project Staff Member with expertise in electricity sector finance and/or operations
- Junior Project Staff Member with experience in utility investor surveying and infrastructure privatization

Evaluation Criteria

Consultants will be selected on the following criteria:

- Curriculum vitae of proposed staff: 50%
- Proposed Approach (elaboration and improvements on above Work Plan): 15%
- Proposed Management Plan (time allocations and use of senior staff): 10%
- Firm Experience in Electricity Sector Privatization and Restructuring: 15%
- Firm Experience in Infrastructure Privatization in the region: 10%

Consultants will be judged according to their knowledge of the issues surrounding electricity industry structure, experience with restructuring and privatizing small to mid-sized systems in developing countries, and operational or financial experience in the power sector. As a whole, the team will also be judged according to its combined experience and complementary skills in conducting quick and thorough electricity sectoral restructuring studies such as that described in this Terms of Reference. This will allow one team member's operational skills, experience working in the region, or surveying experience, for example, to compensate for other team members who may offer different skills.

Consultants are asked to provide references for all past projects listed on curriculum vitae and in the statement of firm qualifications.

Technical Proposal Contents

The Technical Proposal should contain:

- a brief background on the proposed consulting team specifying the degree to which the firms and individuals have collaborated on past assignments;
- a proposed approach or work plan that elaborates on the approach and outline provided in this ToR;
- a management plan that relates the team members to the tasks to be performed and describes each team member's planned contribution to the analysis in person/days and according to task;
- firm qualifications of each corporate member of the consortium;
- full cv's of each individual consultant who is proposed;
- Gantt or bar charts detailing the duration of each task and the involvement of individuals over time.

Total Points of Technical Proposal: 100

The technical proposal will be scored as follows.

Evaluation Criteria

Consultants will be selected on the following criteria:

- Proposed Approach (value added of work plan, originality)
10 points (10%)
- Proposed Management Plan (levels of effort, use of key staff, field time, previous experience working as a team, permanent staff status, appropriateness of assignments)
15 points (15%)

- Firm Experience
25 points (25%) of which:
 - Utility/power sector regulation, legal development - 15 points (15%)
 - Small scale regulation - 5 points (5%)
 - Regional experience - 5 points (5%)
- Curriculum Vitae Of Proposed Staff
50 points (50%) of which:
 - Regulatory specialist - 20 points (20%)
 - International lawyer - 20 points (20%)
 - Local lawyer - 10 points (10%)

Consultants will be judged according to their knowledge and expertise in development of regulatory framework for private participation in the power sector; in drafting legislation and administrative orders; in institutional arrangements for regulation; and in training need assessment.

As a whole, the team will also be judged according to its combined experience and complementary skills in conducting thorough analysis such as that described in this Terms of Reference. This will allow one team member's functional skills or regional experience, for example, to compensate for other team members who may offer different skills.

Consultants are asked to provide references for all past projects listed on curriculum vitae and in the statement of firm qualifications. All firm qualifications should be seven years old or less.

(5) Rail Sector

Strategy for Pilot PSP in Rail sector

Terms of reference for technical assistance

1. State Railways of Growthland (SRG)

The State Railways of Growthland (SRG) is the state-owned enterprise with primary responsibility for rail services in Growthland. At present, SRG is directly responsible for services over a network of 5200 km of track. It employs 30,400 staff and serviced 70.2 m passenger and 20.23 m freight ton per annum in 1999. Operating revenue in the financial year ended 1999 was GrDollars 6,342 million. In 1998, SRG provided 3.3 % of the services to passengers using public transport in Growthland (all modes) and 1.8 % of the freight ton carried. Road transport dominates the transport sector with bus and car for passengers and truck for freight leading the way. In 1999, Government spend on maintenance and new roads was GrDollars 49,205 million.

2. Challenges facing SRG

SRG faces a number of challenges. It is currently operating at a significant annual deficit of approximately GrDollars 4 billion. Fares have been frozen for some time and there is currently no clear policy or funding mechanism to support rail services. It is not currently viewed as a preferred method of travel for passengers nor is it competitive with road hauliers for freight business.

Significant investment is needed in both track and rolling stock in order to improve service quality. Current service levels are deemed poor and are declining. Manning levels and quality of existing personnel are also pressing issues facing the railway. Government does not have the allocated resources to rectify this position.

3. The Reform Process

In response to these challenges, SRG supported by the Growthland Government and the Regional Development Bank, has instituted a policy of major reforms with the aim of creating a sustainable and customer focused railway service which can contribute effectively to Growthland's wider transport needs. This process commenced with the appointment of advisers in April 1999 to address the short term cash flow crisis facing the SRG. Subsequently, a consortium of specialist advisers was appointed in March 2000 to formulate long term strategy and structural options for reforming SRG and introducing Private Sector Participation (PSP). These advisers completed their work in November 2000. All initiatives under the umbrella policy of reforms are being led by a senior agency called reporting directly to Cabinet called the Office of Economic Reform and Infrastructure Privatization (OERIP). The Transport Committee of the OERIP is overseeing all rail, port, airport, metro and toll road initiatives in close collaboration with the relevant line ministries.

Government is now ready to implement a comprehensive program of restructuring, focusing on the establishment of commercially focused and operated business units and simultaneous piloting of PSP with a focus on implementing significant change within the next two years. As a start, introduction of a pilot program of PSP is scheduled to be implemented within 6 months of year 2002. In order to proceed to fast track PSP immediate restructuring of the whole industry has been identified as the main priority.

4. Objectives of this Consultancy

The primary objectives of this consultancy are to:

- Identify a core business unit eligible for pilot PSP initiative;
- Set out the plan for conducting the pilot PSP initiative.

Required deliverables are set out in more detail below.

5. PSP Fast-track Option

As mentioned above, the Growthland Government intends to implement full-fledged PSP as soon as the SRG restructuring is finalized. In order to achieve this goal the Government has decided to pursue a dual track approach to reform. This involves overall restructuring of SRG's businesses with a parallel strategy involving the piloting of certain services for earlier PSP with the medium term goal of introducing full PSP. Fast track introduction of PSP is expected to take place as a priority in a core business defined as rolling stock operations of passengers and or freight, or bundled track and rolling stock operations of a line or segment of SRG.

It is envisaged that the pilot PSP schemes will involve significant risk transfer to the private sector—such as through a concession or sale—whilst delivering efficiency gains on both financial and operational performance.

The Consultant will be required to assess and advise on the selection of fast track candidate business units and to assist SRG to carry out the pilot privatization as part of this phase of the study. This will involve developing transparent selection criteria for selecting the aspects of SRG to be privatized and supporting viability analysis from a financial, commercial, operational and marketing perspective. The output will be a strategy for delivering a significant portion of SRG's above rail business or a key segment into the private sector within 9 months of the completion of this study.

6. Regulatory and Legal Arrangements

A separate Terms of Reference has been issued for the establishment of a regulatory structure the rail sector of Growthland. It will be the responsibility of the consultant hired under these Terms of Reference to coordinate with the other advisors and ensure that a regulatory arrangement will be delineated that will serve the fast-track privatization program without interfering in the long-term arrangements. This coordination will be facilitated by the Office of Economic Reform and Infrastructure Privatization's Transport Committee.

7. Outputs

Specific deliverables will include:

- development of selection matrix for identifying fast-track targets;
- support to management in selecting fast-track candidate(s);
- action plan for introduction of PSP;
- framework tender documents, including a preliminary information memorandum;
- timetable for tendering;
- checklist of tender documents; and
- ToR for appointment of transaction advisers to manage tender/concession process.

At the end of this work module SRG should be in the position to launch a tender process at the earliest opportunity for the selected fast-tracked businesses. This module will not involve the actual tendering process which will form the core of the next phase of work to be covered in a separate ToR the formulation of which (with the specific objective of meeting the nine month deadline referred to above) will, however, form part of this assignment.

8. Management Plan

Qualifications

The assignment is for a team led by a senior rail sector specialist supported by industry financial and operational analyst(s) as well as a PSP specialist. The senior sector specialist should have extensive experiences with defining operational arrangements for railroads and with best practices for institutional arrangements for private operators. The financial analysts and PSP should hold the requisite skills to model the different business units and determine the appropriate unit to be spun-off. The PSP specialist should have extensive experience in the design of privatizations and concessions so as to facilitate the strategy design once the unit has been selected.

Duration and Levels of Effort

It is expected that the consultancy will last about 18 weeks from mobilization to completion. The consultancy is estimated to require approximately 60 person/weeks in total, including 10 person-weeks for the lead sector specialist, 20 person-weeks for operational specialists; 22 person-weeks for financial specialists and 8 person-weeks for the PSP expert.

9. Proposal Structure and Scoring Criteria

Type of Contract and Budget

As mentioned in the attached Data Sheet, the selection method will be Quality and Cost Based.

After the technical bids have been ranked, all firms/consortia with technical proposals scoring over 80 percent will be invited to participate in the Public Opening of the financial proposals. At that stage, the Financial Scores will be calculated and added to the technical scores according to the following weighting:

- Technical Proposal: 85 %
- Financial Proposal: 15%

If the financial proposal of the firm with the highest combined score has been calculated without error (rates, levels of effort, fees, expenses, per diem, taxes, etc.), then that firm will be invited to enter into negotiations with the Government of Growthland to conduct the consultancy.

Technical Proposal

The Technical Proposal should contain:

- a brief background on the proposed consulting team specifying the degree to which the firms and individuals have collaborated on past assignments;
- a proposed approach or work plan that elaborates and/or improves upon the approach and outline provided in these ToR;
- a management plan that relates the team members to the tasks to be performed and describes each team member's planned contribution to the analysis in person/days in Growthland and at home and according to task;
- firm qualifications of each corporate member of the consortium;
- full cv's of each individual consultant who is proposed;
- Gantt or bar charts detailing the duration of each task and the involvement of individuals over time.

Financial Proposal

The Financial Proposal should contain:

- Fee breakdown: Daily rates and numbers of days, by task, of each member of the consulting team
- Expenses: All meals, hotel, travel, incidentals, communication, production, facilities and other expenses anticipated for the project;
- Calculation of total cost.

Proposal evaluation

The technical proposal will be scored as follows.

- Proposed Approach (value added of work plan, originality)
15 points (15%)
- Proposed Management Plan (levels of effort, use of key staff, field time, previous experiences working as a team, appropriateness of assignments)
10 points (10%)
- Firm Experience
25 points (25%) of which:
 - Rail operations and management 10 points (15%)
 - Financial and operational modeling of railroads 5 points (5%)
 - Privatization experience (in transport, and in region) 10 points (10%)
- Curriculum Vitae Of Proposed Staff
50 points (50%) of which:
 - Lead rail operations specialist 17 points (20%)
 - Operational specialist/s 11 points (20%)
 - Financial specialist/s 11 points (20%)
 - PSP Specialist 11 points (10%)

10. Submission information

The original and 3 copies of the technical proposal as well as the original and 3 copies of the financial proposal should be sent jointly in separate envelopes to the following address:

Office of Economic Reform and Infrastructure Privatization
Ministry of Finance Complex
Capital City
Republic of Growthland
Attention: Transport Committee: Rail PSP

Proposals must arrive at OERIP no later than 1700 hours on 12 January 2002.

Annex 2: Sample Evaluation Form¹⁹

The evaluation report includes five sections:

- Section I. A Short Report Summarizing the Findings of the Technical Evaluation;
- Section II. Technical Evaluation Report—Forms;
- Section III. A Short Report Summarizing the Findings of the Financial Evaluation;
- Section IV. Financial Evaluation Report—Forms;
- Section V. Annexes:
 - Annex I. Individual Evaluations;
 - Annex II. Information Data Monitoring;
 - Annex III. Minutes of the Public Opening of the Financial Proposals;
 - Annex IV. Copy of the Request for Proposals;
 - Annex V. Miscellaneous Annexes – Ad Hoc.

The report can be used for all methods of selection though it mainly addresses Quality- and Cost-Based Selection, each section contains a note indicating the data and forms that are to be provided for the other methods of selection.

For complex, specialized assignments, borrowers may wish to obtain assistance from consultants to evaluate proposals. Such consultants or individual consultants may be financed under the relevant loan, credit, or grant.

¹⁹ Based on World Bank evaluation requirements.

CONSULTANT EVALUATION REPORT

Country [insert: name of country]

Project Name [insert: project name]

Loan/Credit No. [insert: loan/credit number]

Title of Consulting Services [insert: title]

Date of Submission [insert: date]

Section I. Technical Evaluation Report—Text²⁰

- 1. Background** Include a brief description, context, scope, and objectives of the services. Use about a quarter of a page.

- 2. The Selection Process (Prior to Technical Evaluation)** Elaborate on information provided in Form IIA.

Describe briefly the selection process, beginning with the advertising (if required), the establishment of the shortlist, expressions of interest, and withdrawals of firms before proposal submissions. Describe major events that may have affected the timing (delays, complaints from consultants, key correspondence with the Bank, Request for Proposals (RFP), extension of proposal submission date, and so on).

Use about one-half to one page.

- 3. Technical Evaluation** Describe briefly the meetings and actions taken by the evaluation committee: formation of a technical evaluation team, outside assistance, evaluation guidelines, justification of subcriteria and associated weightings as indicated in the Standard Request for Proposals; relevant correspondence with the Bank; and compliance of evaluation with RFP.

Present results of the technical evaluation: scores and the award recommendation.

Highlight strengths and weaknesses of each proposal (most important part of the report).
 - (a) **Strengths:** Experience in very similar projects in the country; quality of the methodology, proving a clear understanding of the scope of the assignment; strengths of the local partner; and experience of proposed staff in similar assignments.

 - (b) **Weaknesses:** Of a particular component of the proposal; of a lack of experience in the country; of a low level of participation by the local partner; of a lack of practical experience (experience in studies rather than in implementation); of staff experience compared to the firm's experience; of a key staffer (e.g., the team leader); of a lack of responsiveness; and of disqualifications (conflict of interest).
Comment on individual evaluators' scores (discrepancies).

Items requiring further negotiations.

Use up to three pages.

²⁰ Section I applies to Quality- and Cost-Based Selection (QCBS), Quality-Based Selection (Quality-Based), Fixed-Budget Selection (Fixed-Budget), and Least-Cost Selection (Least-Cost). Provide appropriate information in the case of Selection Based on Qualifications (Qualifications) and Single-Source Selection (SS).

Section II. Technical Evaluation Report—Forms ²¹

Form IIA. Technical Evaluation—Basic Data
Form IIB. Evaluation Summary—Technical Scores/Ranking
Form IIC. Individual Evaluations—Comparison (Average Scores)

Form IIA. Technical Evaluation - Basic Data

2.1 Name of country _____

Name of Project _____

2.2 Client:

(a) name _____

(b) address, phone, facsimile _____

2.3 Type of assignment (pre-investment, preparation, or implementation), and brief description of sources

2.4 Method of selection²² : QCBS ____ Quality-Based ____
Fixed-Budget ____ Least-Cost ____
Qualifications ____ Single-Source ____

2.5 Prior review thresholds: US\$ _____

(a) Full prior review US\$ _____

(b) Simplified prior review (notice)

²¹ Section II applies to Quality- and Cost-Based Selection (QCBS), Quality-Based Selection (Quality-Based), Fixed Budget Selection (Fixed-Budget), and Least-Cost Selection (Least-Cost). Supply appropriate data in cases of Selection Based on Qualifications (Qualifications) and Single-Source Selection (Single-Source) in Form IIA.

²² See Guidelines.

2.6 Request for expressions of interest²³:

(a) publication in *United Nations Development Business* (UNDB)²⁴ Yes _____ No _____

(b) publication in national newspaper(s) Yes _____ No _____

(c) number of responses _____

2.7 Shortlist:

(a) names/nationality of firms/associations (mark domestic firms and firms that had expressed interest) 1. _____
2. _____
3. _____

(b) Submission to the Bank for no-objection Date _____

(c) Bank's no-objection Date _____

2.8 Request for Proposals:

(a) submission to the Bank for no-objection Date _____

(b) Bank's no-objection Date _____

(c) issuance to Consultants Date _____

2.9 Amendments and clarifications to the RFP (describe)

2.10 Contract:

(a) Bank Standard Time-Based Yes _____

(b) Bank Standard Lump Sum Price adjustment: Yes _____ No _____

(c) other (describe) Yes _____
Price adjustment: Yes _____ No _____

2.11 Pre-proposal conference: Yes _____ No _____

(a) minutes issued Yes _____ No _____

²³ Required for large contracts (see Guidelines).

²⁴ Indicate whether expressions of interest advertised in Web or hardcopy edition of UNDP.

2.12 Proposal submission:	Points
(a) two envelopes (technical and financial proposals)	Yes _____
(b) one envelope (technical)	Yes _____
(c) original submission	Date _____ Time _____
(d) extensions(s)	Date _____ Time _____
2.13 Submission of Financial Proposal	Location _____
2.14 Opening of Technical Proposals by selection committee	Date _____ Time _____
2.15 Number of proposals submitted	_____
2.16 Evaluation committee ²⁵ :	1. _____
Members' names and titles (normally three to five)	2. _____
	3. _____
2.17 Proposal validity period (days):	
(a) original expiration date	Date _____ Time _____
(b) extension(s), if any	Date _____ Time _____
2.18 Evaluation Criteria/subcriteria ²⁶ :	
(a) Consultants' experience	
(i) _____	Weight _____
(ii) _____	Weight _____
(b) methodology	
(i) _____	Weight _____
(ii) _____	Weight _____

²⁵ It is important that evaluators be qualified.
²⁶ Maximum of three subcriteria per criterion.

(c) key staff

(i) individual(s)

(A) _____ Weight _____

(B) _____ Weight _____

(C) _____ Weight _____

(ii) group(s)

(A) _____ Weight _____

(B) _____ Weight _____

(C) _____ Weight _____

(d) training (optional)

(i) _____ Weight _____

(ii) _____ Weight _____

(e) local input (optional)

(i) _____ Weight _____

(ii) _____ Weight _____

Consultants' names

Technical scores

1. _____

2. _____

3. _____

4. _____

2.20 Evaluation report:

(a) submission for no-objection

Date _____

Form IIB. Evaluation Summary

Technical Scores/Ranking

Consultants' names	[Insert name of Consultant 1]	[Insert name of Consultant 2]	[Insert name of Consultant 3]	[Insert name of Consultant 4]
Criteria	Scores	Scores	Scores	Scores
Experience				
Methodology				
Proposed staff				
Training				
Local input				
Total score^a				
Rank				

a Proposals scoring below the minimum qualifying score of [number] points have been rejected.

Form IIC. Individual Evaluations—Comparison

Consultants' Names	[Insert name of Consultant 1]	[Insert name of Consultant 2]	[Insert name of Consultant 3]	[Insert name of Consultant 4]
Criteria	Scores	Scores	Scores	Scores
Experience				
Methodology				
Key staff				
Training				
Local input				
Total				

a. A, B, C, and D = scores given by evaluators; AV = average score, see Annex (f).

Section III. Financial Evaluation Report—Award Recommendation—Text²⁷

[The text will indicate:

- (a) any issues faced during the evaluation, such as difficulty in obtaining the exchange rates to convert the prices into the common currency used for evaluation purposes;
- (b) adjustments made to the prices of the proposal(s) (mainly to ensure consistency with the technical proposal) and determination of the evaluated price (does not apply to Quality-Based (Quality-Based), Selection Based on Qualifications (Qualifications), and Single-Source Selection (Single-Source));
- (c) tax-related problems;
- (d) award recommendation; and
- (e) any other important information.

Taxes are not taken into account in the financial evaluation whereas reimbursables are.]

²⁷ Applies to QCBS, Fixed-Budget, and Least-Cost. For Quality-Based, Qualifications, and Single-Source provide relevant information as indicated.

Section IV. Financial Evaluation Report—Award Recommendation—Forms

Form IVA. Financial Evaluation—Basic Data

Form IVB. Adjustments—Currency Conversion—Evaluated Prices

Form IVC. QCBS—Combined Technical/Financial Evaluation—Award Recommendation

Form IVD. Fixed-Budget and Least-Cost Selection—Award Recommendation

Form IVA. Financial Evaluation—Basic Data

4.1	Bank's no-objection to technical evaluation report (Quality-Based, Qualifications, Single-Source)	Date	_____		
4.2	Public opening of financial proposals	Date	Time	_____	
	(a) Names and proposal prices (mark Consultants that attended public opening)	1.	_____		
		2.	_____		
4.3	Evaluation committee: members' names and titles (if not the same as in the technical evaluation - Quality-Based, Qualifications, Single-Source)		_____ _____		
4.4	Methodology (formula) for evaluation of cost (QCBS only; cross as appropriate)	Weight inversely proportional to cost	_____		
		Other	_____		
4.5	Submission of final technical/financial evaluation report to the Bank (Quality-Based, Qualifications, Single-Source)	Date	_____		
4.6	QCBS	Consultant' Name	Technical scores	Financial scores	Final scores
	(a) Technical, financial and final scores (Quality-Based: technical scores only)	_____	_____	_____	_____
	(b) Award recommendation	_____			

²⁸ Applies to QCBS, Fixed-Budget, and Least-Cost. For Quality-Based, Qualifications, and Single-Source, provide relevant information as indicated.

4.7 Fixed Budget and Least-Cost	Name	scores	prices	prices
(a) Technical scores, proposal and evaluated prices	_____	_____	_____	_____
(b) Award recommendation	_____	_____	_____	_____
(c) Fixed budget best technical proposal within the budget	Name:			
	Name:			
(d) Least Cost: Lowest evaluated proposal above minimum qualifying score	Name:			

Form IVB. Adjustments—Currency Conversion—Evaluated Prices²⁹

Consultants' Names	Proposals' prices ^a		Adjustments ^b	Evaluated price(s)	Conversion to currency of evaluation ^c		Financial scores ^d
	Currency	Amounts (1)			Exchange rate(s) ^e (4)	Proposals' prices (5) = (3)(4) (6)	
			(2)	(3) = (1) + (2)			

- a. Comments, if any (e.g., exchange rates); three foreign currencies maximum, plus local currency.
- b. Arithmetical errors and omissions of items included in the technical proposals. Adjustments may be positive or negative.
- c. As per RFP.
- d. 100 points to the lowest evaluated proposal; other scores to be determined in accordance with provisions of RFP.
- e. Value of one currency unit in the common currency used for evaluation purposes, normally the local currency (e.g., US\$1 = 30 rupees). Indicate source as per RFP.

²⁹ For Quality-Based, Qualifications, and Single-Source, fill out only up to column 3.

Form IVC. QCBS — Combined Technical/Financial Evaluation — Award Recommendation

Technical Evaluation	Technical Evaluation			Financial Evaluation		Combined Evaluation	
	Technical scores $S(t)$	Weighted scores $S(t) \times T$	Technical rank	Financial scores $S(f)$	Weighted scores $S(f) \times F$	Scores $S(t) T + S(f) F$	Rank
Award recommendation To highest combined technical/financial score. Consultant's name: _____							

Form IVD. Fixed-Budget and Least-Cost Selection — Award Recommendation³⁰

Consultants' names	Fixed-Budget Selection		Least-Cost Selection	
	Technical scores	Evaluated prices	Technical scores	Evaluated prices
Award recommendation	To best technical score with evaluated price within budget. Consultant's name:		To lowest evaluated price above minimum qualifying score. Consultant's name:	

³⁰ Fill in appropriate part of form.

Section V. Annexes³¹

Annex I. Individual Evaluations

Form V Annex I(i). Individual Evaluations

Form V Annex I(ii). Individual Evaluations — Key Personnel

Annex II. Information Data Monitoring

Annex III. Minutes of Public Opening of Financial Proposals

Annex IV. Request for Proposals

Annex V. Miscellaneous Annexes—Ad Hoc

³¹ Annex I applies to Quality-Based, Fixed-Budget and Least-Cost. For Qualifications and Single-Source, it is replaced by a review of the strengths and weaknesses of the proposal, which may be amended by one or several evaluators.

Annex I (j). Individual Evaluations

Consultant's name: _____

Criteria/Sub-Criteria	Maximum Scores	Evaluators					Average Scores
		1	2	3	4	5	
Experience							
-							
-							
-							
Methodology							
-							
-							
-							
Key Staff							
-							
-							
-							
Transfer of Knowledge (Training ^a)							
-							
-							
-							
Participation by Nationals ^a							
-							
-							
-							
Total	100						

a. If specified in the RFP

1. Evaluator's Name: _____ Signature: _____ Date: _____
2. Evaluator's Name: _____ Signature: _____ Date: _____
3. Evaluator's Name: _____ Signature: _____ Date: _____
4. Evaluator's Name: _____ Signature: _____ Date: _____
5. Evaluator's Name: _____ Signature: _____ Date: _____

Annex I(ii) Individual Evaluations—Key Personnel

Consultant's Name: _____

Key Staff Names a	Maximum Scores	General Qualifications ()b	Adequacy for the Assignment ()b	Experience in Region ()b	Total Marks (100)	Scores
Total						

a. Sometimes evaluations are made by groups instead of individuals. Each group (e.g. financial group) has a weight. The group score is obtained by the weighted scores of the members of the group. For example, the score of a group of three individuals scoring a, b, and c would be $ax + by + cz$ with x, y, and z representing the respective weights of the members ($x + y + z = 1$) in this group.

b. Maximum marks as per RFP

Name of Evaluator: _____ Signature: _____ Date: _____

Annex II. Information Data Monitoring

5.1 Loan/credit/grant

- (a) number _____
- (b) date of effectiveness _____
- (c) closing date _____
- (i) original _____
- (ii) revised _____

5.2 General Procurement Notice

- (a) first issue date _____
- (b) latest update _____

5.3 Request for expressions of interest³²:

- (a) publication in *United Nations Development Business* (UNDB) _____ Date _____
- (b) publication in national local newspaper(s) _____ Name of newspaper(s) and date(s) _____

5.4 Did the use of price as a factor of selection change the final ranking?³³ Yes _____ No _____

5.5 Did the use of "local input" as a factor of selection change the technical ranking?³⁴ Yes _____ No _____

³² Required for large contracts (see Guidelines).

³³ Compare technical rank with rank in Form IVC.

³⁴ Figure out technical scores with and without "local input" (Form IIB).

Annex III. Minutes of Public Opening of Financial Proposals³⁵

MINUTES

[The minutes should indicate the names of the participants in the proposal opening session, the proposal prices, discounts, technical scores, and any details that the Client, at its discretion, may consider appropriate.]

All attendees must sign the Minutes.]

³⁵ Annex III applies to QCBS, Fixed-Budget, and Least-Cost.

Annex 3: Format of Technical and Financial Proposals (from World Bank)

Technical Proposal

FROM:

TO:

Sir/Madam:

Subject: *Hiring of Consultancy Service for*

Regarding Technical Proposal

I/We_____Consultant/Consultancy firm herewith enclose a Technical Proposal for selection of my/our firm/organization as Consultant for_____

Yours faithfully,

Signature

(Authorized Representative)

Full Name

Designation

Address

Firm's References

Relevant Services Carried Out in the Last Five Years which Best Illustrate Qualifications

Using the format below, provide information on each reference assignment for which your firm, either individually as a corporate entity or as one of the major companies within a consortium, was legally contracted.

Assignment Name:		Country:
Location within Country:		Professional Staff Provided by Your Firm:
Name of Client:		No of Staff:
Address:		No of Staff Months:
Start Date (Month/Year):	Completion Date (Month/Year):	Approx. Value of Services (in Current USD):
Name of Associated Firm(s), if any:		No of Months of Professional Staff Provided by Associated Firm(s):
Name of Senior Staff (Project Director/Coordinator, Team Leader) involved and functions performed:		
Narrative Description of Project:		
Description of Actual Services Provided by Your Staff:		

Approach Paper on Methodology Proposed for Performing the Assignment:

etc

Comments/Suggestions of Consultant:

On the Terms of Reference (TOR):

- 1.
- 2.
- 3.

etc.

On the data, services and facilities to be provided by the Client indicated in the TOR:

- 1.
- 2.
- 3.

etc.

Format of Curriculum Vitae (CV) For Proposed Key Staff

Proposed Position: _____

Name of Firm: _____

Name of Staff: _____

Profession: _____

Date of Birth: _____

Years with Firm: _____ Nationality: _____

Membership in Professional Societies: _____

Detailed Tasks Assigned: _____

Key Qualifications:

[Give an outline of staff member's experience and training most pertinent to tasks on assignment. Describe degree of responsibility held by staff member on relevant previous assignments and give dates and locations. Use up to half a page.]

Education:

[Summarize college/university and other specialized education of staff member, giving names of schools, dates attended and degrees obtained. Use up to a quarter page.]

Employment Record:

[Starting with present position, list in reverse order every employment held. List all positions held by staff member since graduation, giving dates, names of employing organization, title of positions held and location of assignments. For experience in last ten years, also give types of activities performed and client references, where appropriate. Use up to three-quarters of a page.]

Languages:

[Indicate proficiency in speaking, reading and writing of each language: excellent, good, fair, or poor.]

Certification:

I, the undersigned, certify that to the best of my knowledge and belief, these biodata correctly describe myself, my qualifications and my experience.

Date:

Signature of Staff Member or authorized official from the firm
Day/Month/Year

Work Plan and Time Schedule for Key Personnel

Name	Position	Reports Due/Activities	Months (in the form of a Bar Chart)												Number of Months				
			1	2	3	4	5	6	7	8	9	10	11	12					
																		Subtotal (1)	
																			Subtotal (2)
																			Subtotal (3)
																			Subtotal (4)

Full Time:
Part Time:

Reports Due:
Activities Duration

Yours faithfully,

Signature

(Authorized Representative)

Full Name

Designation

Address

Composition of the Team Personnel and the Task which would be assigned to each Team Member

1. Technical/Managerial Staff

Name	Position	Task Assignment

2. Support Staff

Name	Position	Task Assignment

Work Plan/Time Schedule

1. Field Investigation

Items of Work/Activities	Monthly Program from date of assignment (in the form of a Bar Chart)											
	1	2	3	4	5	6	7	8	9	10	11	12

2. Completion and Submission of Reports (as indicated under Appendix B enclosed with General Conditions of Contract)

Reports	Date
1. Inception Report	
2. Interim Progress Report	
(a) First Status Report	
(b) Second Status Report	
3. Draft Report	
4. Final Report	

Financial Proposal

FROM: TO:

Sir/Madam:

Subject: *Hiring of Consultancy Service for*

Regarding Price Proposal

I/We _____ Consultant/Consultancy firm herewith enclose the Price Proposal of my/our firm/organization as Consultant for _____

Yours faithfully,

Signature

(Authorized Representative)

Full Name

Designation

Address

Schedule of Summary Price Proposal

Name of Activities	Currency	Amount	
		In Words	In Figures
Total Amount			

Breakdown of Summary Price

For Activity N°: _____ Name: _____

Price Component	Currency	Amount
Remuneration for basic services		
Out-of-pocket expenses		
Computer software cost		
Miscellaneous expenses		
Subtotal		

Note:

The above form is to be filled up separately for each activity mentioned in Appendix 2, page 2 of 7.

Consolidated Summary for Remuneration in Respect of Basic Services

For Activity No: _____ Name: _____

Name	Position	Staff-Months	Monthly Rate	Total Amount Expected to be Paid
Total				

Note:

1. Breakdown of the cost and charges for monthly rates is indicated in Appendix 2, page 5 of 7.
2. This form is to be filled out separately for each activity mentioned in Appendix 2, page 2 of 7.

Out-of-Pocket Expenses

For Activity No: _____ Name: _____

S. No	Nomenclature	Unit	Quantity	Unit Price	Total Amount
1.	Return flights between and	Trip			
2.	Miscellaneous travel expenses	Trip			
3.	Subsistence allowance	Trip			
4.	Local transportation costs ¹				
5.	Office rent/accommodation/clerical asst.				
Total					

Note:

This is to be filled out separately for each activity mentioned in Appendix 2, page 2 of 7.

¹ Local transportation costs are not included if local transportation is being made available by Client. Similarly, in the Project site, office rent/accommodations/clerical assistance costs are not to be included if being made available by Client.

Computer Software Costs
(Inclusive of Licensing of Software)

S1 No	Software	Amount
1.		
2.		
3.		
4.		
Total		

Miscellaneous Expenses

For Activity No: _____ Name: _____

S. No	Nomenclature	Unit	Quantity	Unit Price	Total Amount
1.	Communication costs between _____ and _____ (telephone, telegram, telex)				
2.	Drafting, reproduction of reports				
3.					
4.					
5.					
Total:					

Note:

This is to be filled out separately for each activity mentioned in Appendix 2, page 2 of 7.

Glossary

Advisor	An individual or company providing information and/or recommendations
Analysis	The production of a report or statement setting out the underlying reasons for or causes of a particular event or outcome
Bait and switch	The practice of enticing a client by promising the participation of particular individuals and, once the client is committed, switching the promised individuals for others
Billing schedule	Description of when and under what conditions invoices (bills) can be submitted
Bottom line	In financial proposals, the minimum acceptable level
Bribe	Receipt of anything, monetary or otherwise, in return for an action that would otherwise be prohibited
Chinese wall	Measures put in place to prevent the flow of specified information from one individual, or set of individuals, to another individual or set of individuals
Competition	Three main forms: in <i>the market</i> , the normal attempt to attract customers for your good as opposed to another similar good, <i>for the market</i> one off contest to provide services to a particular group, may be repeated at intervals, <i>contestability</i> pressure from potential new entrants. Also <i>yardstick (or comparative)</i> for regional monopolies imposed by only allowing tariffs based on costs of other, similar, companies (e.g., power and water distribution)
Concession	Contractual arrangement that transfers responsibility for asset management and new investment
Concessionary lending	Lending below the prevailing market interest rate for the type of loan in question
Consensus	A generally held point of view
Conflict of Interest	This arises when parties have incentives to behave in most appropriate manner do not exist because of influence from other interests or projects
Consortium	Group of companies—usually with a single lead company and others subcontracted

Consultant	See advisor
Contract	A formal, written agreement that creates legally binding or enforceable obligations on some or all the parties
Corruption	Accepting a bribe (see bribe)
Covenant	Agreement, promise or guarantee, as in a <i>financial covenant</i> requiring a sum of money be set aside as a guarantee for certain actions
Current cost valuation	Value of an asset based on the cost of acquiring the same asset today
Divestiture	To sell a controlling interest
Donor	Agency that lends money at a concessionary rate. Often divided into multilateral, where lending is controlled by many countries, and bilateral, where lending policy is controlled by one country.
Drawdown contract	See Indefinite quantity contract
Due diligence	Investigation and assessment of a potential project or assets
Economic value	Discounted expected net cash flow
Efficiency	Distribution of resources to their most valuable use—generally divided into three types: <i>productive</i> , in which a given output is produced at minimum cost given existing inputs at a point in time; <i>allocative</i> , in which inputs are assigned to activities where they are most useful at a point in time; and <i>dynamic</i> , in which inputs are assigned to their best use over time.
Evaluator	Person marking proposals, bids and other submissions
External Advisor	Advisor from outside the organization (also see Advisor)
Feather-bedding	This occurs when advisors unnecessarily expand the terms of reference
Fee rate	Charge for the time of the advisor, excluding all expenses (see also Per Diem, Reimbursable)
Financial instrument	The transfer of risk, such as long term bonds and insurance

Financial proposal	Sets out the monetary terms required to undertake a project
Fixed fee	A single fee for delivering an output that does not vary (e.g., does not change depending on time it takes to deliver the output or other costs of output)
Framework contract	See Indefinite quantity contract
Grant funds	Funds lent that have no interest payment attached to them and are not to be repaid
Greenfield project	A project built from scratch, i.e., without building on an existing or older similar project (e.g., a new water treatment plant)
Gross Domestic Product (GDP)	Total value of all output produced within a country
Historic cost	Value based on the actual cost of acquiring the existing assets
Hydroelectric	Electricity generation based on the kinetic energy of water
Implementation	Putting in place
Indefinite quantity contract (IQC)	Contract for an unspecified amount of work, usually over a few years
Industry restructuring	Altering the relationship between organizations within a sector (possibly including dividing single organizations into multiple parts)
Infrastructure	The underlying physical structure of a country, often with monopoly elements and usually involving the delivery of goods, people or information. For the purposes of this Toolkit, these include power (electricity generation, transmission and distribution, and gas distribution); sanitation (water, sewerage and solid waste services); telecommunication networks; and transportation (seaports, airports, rail, roads and bridges).
In-house expert	Expert who already works within the organization
Intellectual property	An original idea belonging to an individual or company
International competitive bidding	Selection based on a competition for which companies based outside the host country are eligible

Investor	Company or individual who invests (usually money) into a project in return for future rewards
Invitation to Tender	See Request for proposals
Knowledge transfer	Passing of information from one party to another
Lease	A contractual arrangement in which responsibility for the operation and management of an asset is conferred (see also Contract, Concession)
Letter of invitation	An introduction to an offer to submit a bid
License	A series of legal requirements that must be signed prior to being allowed to participate in a sector (see also Contract)
Loss leader	A project undertaken in the knowledge that it will make a loss, because it will establish the company or individual in the market
Lump sum	See Fixed fee
Management contract	An agreement to manage a company without assuming any responsibility for investment or asset maintenance (see also Lease, Concession)
Market value	Value of an asset, company or idea based on its sale price
Mini-proposal	A brief statement by a company or individual following a shortlisting for a project on a specific topic. May be used instead of a proposal or as a second stage to create a smaller shortlist.
Model	A representation of something on a larger scale
Modern equivalent asset value	Value of an asset based on the cost of replacing it with a modern asset that can perform the same task(s)
Multinational companies	Company with production in more than one country
Natural monopoly	Occurs when the cost of producing a given output decreases as more output is produced within a single firm; used to justify the inefficiency of competition in the market (see also Efficiency, Competition)
Objectives	Goals, aims
Per diem	A daily payment to cover expenses

Performance indicator	A test applied to determine whether expected targets have been met
Policy	A course of action adopted by a government
Pre-qualification	Creation of an initial set of requirements that must be met before a party can bid for the project in question
Private Participation in Infrastructure (PPI)	The introduction of the private sector into the provision of some aspect of infrastructure deliver or services (see Infrastructure, Service contract, management contract, Lease, Concession, Divestiture, Natural monopoly)
Private sector participation (PSP)	Introduction of the private sector to a particular area of the economy
Procurement	To obtain, acquire
Public good	Good for which the benefits of provision cannot be limited to those who pay for its output
Regulator	Individual or agency that oversees a sector—may oversee the economic, technical and legal aspects or some subset of them
Regulatory framework	Legal and economic setting within which a regulator works
Reimbursable	Costs that the advisor can recover from the client
Remuneration	Sum of fee rate and reimbursable expenses (see Fee rate, Reimbursable)
Replacement cost	Value of an asset based on the cost of replacing it
Request for Proposals	A call to submit a proposal for a particular project
Request for tenders	See Request for proposals
Retainer	A fixed fee paid to an advisor for being available to provide advise on a specified issue over a particular period
Risk	Chance
Road show	Presentation of a project or set of assets in a number of cities around the world with the aim of raising interest of awareness of an opportunity (usually an opportunity to invest)

Select	Choose
Service contract	Contract to provide a specific output associated with the operation of a company
Shortlist	A list of individuals or companies allowed to bid for a project
Social goals	Goals generally associated with the distribution of wealth
Sole-sourced	Granting a project, the right to do something or a set of assets to a single party without undertaking a process by which multiple parties can bargain for the right (see International competitive bidding, competition)
Stakeholder	An individual or company with an interest in the issue
Standing charge	A tariff that is independent of the volume consumed
Stranded cost	A cost that cannot be recovered because of a change in market conditions beyond the control of the company in question
Success fee	Payment based on a percentage of the price for which assets (or the right to do something) are sold
Technical assistance	Provision of information and/or advice
Technical proposal	A document setting out the approach that would be adopted to a particular project, along with the individuals and/or companies who would carry out the approach described
Time and materials	Payment based on the amount of time taken to undertake a given task and the cost of the materials used
Track record	Past experience
Transaction cost	The cost of agreeing to undertake something
Transparent	Everyone has access to the same information about the process in question
Unanimous	Everyone in agreement
Up-front costs	Costs, usually fixed, that must be incurred prior to beginning to undertake a project or task

Utility

Company or organization that provides electrical or water services

Value for money

Creation of an outcome (an objective) at minimum cost