



An Approach to Supporting Private Sector Participation in Infrastructure

Benefits, Challenges and Lessons Learnt
from the PIDG

June 2008

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PIDG mission statement 2008

“The Private Infrastructure Development Group is a coalition of donors mobilising private sector investment to help developing countries provide the infrastructure vital to boost their economic development and combat poverty.”

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List of abbreviations

| | | | |
|------------------|---|--------------|--|
| ADA | Austrian Development Agency | PDF | Project Development Facility |
| AsDB | Asian Development Bank | PIDG | Private Infrastructure Development Group |
| AsPIFF | Asian Private Infrastructure Financing Facility | PFF | Project Financing Facility |
| CA | Crown Agents | PM | Programme Manager |
| CLF | Currency Liquidity Facility | PMU | Programme Management Unit |
| DAC | Development Assistance Committee | PPI | Private Participation in Infrastructure |
| DevCo | Infrastructure Development Collaboration Partnership | PPIAF | Public Private Infrastructure Advisory Facility |
| DFI | Development Finance Institution | PSP | Private Sector Participation |
| DFID | UK Department for International Development | SECO | Swiss State Secretary for Economic Affairs |
| DGIS | Directorate General for International Co-operation of the Dutch Ministry of Foreign Affairs | Sida | Swedish International Development Corporation Agency |
| EAIF | Emerging Africa Infrastructure Fund Limited | SIFMA | Standard Infrastructure Fund Managers (Africa) Limited |
| FMO | Netherlands Development Finance Company | TAF | Technical Assistance Facility |
| GPOBA | Global Partnership for Output Based Aid | | |
| GuarantCo | GuarantCo Limited | | |
| IFC | International Finance Corporation | | |
| IFI | International Financial Institution | | |
| InfraCo | InfraCo Limited | | |
| MDGs | Millennium Development Goals | | |
| OBA | Output Based Aid | | |
| OECD | Organisation for Economic Co-operation and Development | | |

Preface

This guide has been developed by the Private Infrastructure Development Group (PIDG), with support from Cambridge Economic Policy Associates (CEPA), commissioned by the PIDG Programme Management Unit (PMU). The objective is to provide insight into the PIDG's experience of setting up and operating a number of infrastructure project development and financing facilities aimed at addressing several private infrastructure and financial market failures. In doing so, the guide aims to highlight certain unique features of the PIDG, the potential benefits of the approaches adopted, as well as the challenges faced and lessons learnt along the way. As such, it is neither a strategic review nor a detailed evaluation, but rather, a collection of insights, provided primarily by those stakeholders who in different ways have worked with the PIDG and its facilities during their most formative years and who have contributed to its many observed achievements. In sponsoring the guide, the PIDG has sought to capture these insights for posterity – to serve as an institutional memory – before many of those involved either move on to new things or else pass on into retirement. Whilst being proud of their achievements, the PIDG members have also sought to produce a guide which reports honestly on many of the difficulties faced, as well as the successes.

The guide therefore provides insight into an approach to encourage private investment in infrastructure in developing countries, which

others may wish to emulate, not only in the infrastructure sector, but possibly adapt for other sectors as well. It is therefore targeted most at donors, which may also include other bilateral donors that are thinking of joining PIDG, or indeed the national governments of developing countries and other organisations seeking to engage with the private sector for infrastructure development. However, others who have a more general interest in the challenges of promoting private investment in infrastructure in the developing world may also find it enlightening.

As set out, in sponsoring this guide, the PIDG has sought to reflect the views of a broad range of stakeholders as honestly as possible. In addition to the PIDG members themselves, facility Board members, facility managers and others familiar with PIDG's operations have been consulted. The approach has been to set out some of the basic facts before reflecting the views of these different groups as regards benefits, challenges and lessons learnt. Sometimes the views expressed represent a consensus of opinion, in other instances, differences. In preparing the report, however, the PMU and CEPA have had to interpret and synthesise these different views in order to produce a cogent document and it is perhaps inevitable that some views may have been misinterpreted and in other instances more outlying views omitted. Despite this, it is hoped that the guide serves its stated purposes.

1

Introduction

1.1. Background to the PIDG

The Private Infrastructure Development Group (PIDG) was established in 2002, with the aim of enhancing the provision of sustainable infrastructure services through increased private sector participation (PSP), thereby promoting economic growth and poverty reduction. From the outset, the PIDG approach has been to focus more on infrastructure development to enhance economic growth as a means of achieving a reduction in poverty and improvement in human development, rather than direct pro-poor interventions, although these have been promoted where possible.

The PIDG has been constituted as a partnership between donor organisations, and seeks to achieve its objectives through the establishment of several facilities, supporting private infrastructure project development and financing in low-income developing countries. Currently in its seventh year of operation, the PIDG is still a relatively new initiative – and therefore its achievements need to be looked at in the light of its operational history. This is particularly the case when considering the economic and development impact of the PIDG activities, given the gestation lags for infrastructure investments. Despite this, however, the PIDG has made a number of significant achievements, including the following:

- It has successfully established two investment vehicles and three project development facilities and has developed strong relationships with other major initiatives encouraging private investment in infrastructure (often funded partly by the same PIDG members, albeit on an individual basis) such as the Global Partnership for Output Based Aid (GPOBA) and the Public-Private Infrastructure Advisory Facility (PPIAF).¹
- As of 2007, the PIDG facilities, taken together, have undertaken a total of 73 projects, spread across more than 30 countries, financed by donor funding of US\$254 million.
- By the end of 2007, investments in the PIDG facilities of US\$490 million (including private sector contributions to the facilities) had helped to mobilise commitments at the project level of over US\$7.7 billion in private sector investment. Total private sector investment committed per dollar of actual PIDG investments is therefore currently in the region of 30:1.
- The projects undertaken by the PIDG facilities have impacted on the economic and development potential of the poor in developing countries including:
 - New and / or improved water, electricity and / or transport infrastructure for 6.3 million people.
 - Fiscal impact in terms of avoided subsidies by developing country governments in excess of US\$510 million, and



increased revenues through upfront government fees of US\$5.8 million.

- Creation of over 10,000 direct employment opportunities, in addition to multiplier effects on employment through greater economic activity and improved business potential.

Recognising the important role of the PIDG and its facilities in today's infrastructure market in developing countries, we view it useful and interesting to examine how the initiative has developed and the strategies that have been employed, to provide some lessons on best practice in supporting private sector participation in infrastructure development.

1.2. Structure of the guide

The guide begins by introducing each of the PIDG facilities and the market and government failures which they have been set up to address. It also shows how the PIDG facilities fit vis-à-vis other interventions aimed at addressing the same failures.

The PIDG structure is then examined at three levels: first, the PIDG Governing Council, the PIDG Trust and the Programme Management

Unit (PMU); second, the PIDG facilities; and third, projects developed and financed by the PIDG facilities. Under each level, the aim is to provide as factual an account as possible of each, before turning to an overview of the key benefits and challenges faced. It is here, in particular, that different stakeholders may have different perspectives. A concluding section is then provided on the key lessons that can be learnt from the PIDG approach.

Accordingly, this report is structured as follows:

- Section 2 sets out how the PIDG fits in to the international donor architecture and some of its defining characteristics.
- Section 3 considers the role of the PIDG governance arrangements, including the PMU, highlighting the key benefits and challenges of the approach.
- Section 4 considers the individual facilities themselves and how they are financed and governed. Important benefits and challenges of the approach used in designing, implementing and operating the facilities are discussed.
- Section 5 looks at the services provided by the PIDG facilities at the project level.
- Finally, Section 6 brings the presentation together to discuss some of the key lessons that can be learnt from the PIDG approach.

2

The role of PIDG in the infrastructure market

The PIDG is neither the only, nor the largest, entity to support PSP in the developing world. It can, as will be shown, be distinguished by its country and sector focus, its targeting of gaps in existing international financial institution (IFI) support of infrastructure development and by innovative arrangements with the private sector. All of these have been helped, to varying degrees, by the PIDG's access to grant, or other highly concessional, financing and the specific approach and structure that it has adopted.

The section begins by providing an overview of the range of PIDG facilities and the high level rationales underlying their development. It then goes on to set out some of the key aspects of the PSP infrastructure project cycle and the areas in which different types of IFIs have traditionally focused their efforts. This is then contextualised and / or contrasted by the focus of the PIDG facilities. Some examples are then provided of where it is considered that the PIDG approach has been in some way unique, in particular noting the PIDG facilities' focus on the poorest and riskiest countries.

2.1. Overview of the PIDG facilities

Infrastructure service provision in poor countries has fallen considerably short of demand. In the face of growing fiscal deficits and the lack of efficiency associated with State bureaucracy, the private sector has an important and complementary role to play in advancing the provision of infrastructure. Indeed, if the infrastructure needed to achieve the Millennium Development Goals (MDGs)² is to be provided, increased levels of private sector investment will be essential.

However, the private sector has not been so forthcoming in developing and financing infrastructure projects due to several market and government failures, in addition to which there is a significant affordability challenge that many infrastructure projects face in most poorer countries. The main challenges can be summarised as:

- the lack of an appropriate enabling environment, in terms of laws, regulations and institutions;
- the insufficient availability of long-term foreign exchange denominated debt, both due to the perceived riskiness of projects and a lack of macroeconomic stability;
- an inability to finance through local currency, because of a lack of depth and breadth of local credit and capital markets;
- the high front-end cost and uncertainty attached to project development;
- a lack of local capacity in both the public and private sectors; and
- the limited affordability of many infrastructure services, due often to either the inherent “lumpiness” of the infrastructure (in terms of its unfavourable cost to revenue profile) or an inability or willingness of users to pay the full costs of service.

Given the above, the PIDG has focused on the setting up of both *project development facilities* (PDFs), introduced to improve project development and execution, and *project financing vehicles* (PFFs) aimed at addressing financial market failures that have created constraints to private investment in infrastructure service provision.³ These are summarised in Figure 2.1.

Figure 2.1: The PIDG facilities and the obstacles to private infrastructure investment development⁴



* Facilities in development

We now consider each of these different types of intervention in detail.

2.1.1. Costs of developing projects and building capacity

The private sector has been reluctant to allocate scarce project development funds to infrastructure projects in emerging markets, due to the perceived high risk nature of early stage infrastructure developments arising from uncertainties in the regulatory, institutional and political environment as well as currency, credit and

market risks. Although donors have financed these activities for many years when they have been public sector led (government and publicly owned utilities), the availability of funds has been severely limited for PSP initiatives and it is only now that this problem is being fully recognised. In addition, governments and their agencies require support to build capacity for working efficiently and effectively with the private sector. In response to these gaps the PIDG has established the following PDFs:

- **InfraCo Ltd. (InfraCo)** is an infrastructure development company (with a focus on Sub-Saharan Africa), that seeks to address the lack of projects developed that are suitable for private investment in the poorer developing countries. It has been designed to assume the risks and costs of early stage project development in areas where many traditional developers have retreated, thereby adding value by crowding in additional investment. It initiates the development of innovative ventures from an early conceptual stage, secures in-principle commitments from providers of finance, and subsequently offers structured investment opportunities to private sector investors. By managing the project development process, InfraCo is involved with all phases of project development such as feasibility assessment, project structuring, etc. InfraCo's involvement is designed to catalyze new investment in projects which would not otherwise be undertaken.
- The **Technical Assistance Facility (TAF)** provides funding to the PIDG facilities, to support capacity building and help scope potential investment opportunities. Lack of appropriate capacity and technical expertise of policy making bodies, regulatory agencies and privately managed projects limit the development of infrastructure projects and TAF grants aim to fill this gap by funding all aspects of the development phase, including studies on financing options as well as policy, regulatory and institutional reforms. TAF assists the potential clients of the PIDG

facilities to evaluate, develop and implement pioneering projects. In addition, the TAF has also established a window to provide grants on an output based aid (OBA) basis to address the issues of balancing affordability by the poor with commercial viability – discussed further in Section 2.1.3 below).

- **DevCo**, a PIDG Affiliated Programme⁵ housed within the IFC, provides advisory services to governments for privatization and PSP transactions in infrastructure sectors in poorer developing countries. It allows for expert consultants working with IFC-led teams to prepare projects for private investment. Funds can be used to support marketing, planning and development of transactions, as well as implementation support through specialised consultants. DevCo can also provide partial underwriting of IFC risks associated with advisory mandates.

In addition, from 2008, InfraCo will incorporate a project development and financing vehicle – **InfraCo Asia**, previously known as the Asian Private Infrastructure Financing Facility (AsPIFF) – which will focus specifically on Asia. InfraCo Asia will play a project developer role as well as provide equity and quasi-equity investment products alongside public and private investors, specialising in greenfield infrastructure projects in all infrastructure sectors.

2.1.2. Under developed credit and capital markets

The under developed nature of credit and capital markets in low-income countries creates a market gap for the supply of long term financing, which is typically required for infrastructure financing. In addition, immature financial markets lead to a reliance on foreign project finance and consequently often involve an exchange rate risk which cannot be mitigated. This is a particularly severe problem in countries where national currencies have been historically volatile. The PIDG has sought to address the market failure of limited long term financing for infrastructure by developing the following PFFs:

- The **Emerging Africa Infrastructure Fund Ltd. (EAIF)** is a US\$365 million debt fund that provides long term foreign currency denominated loans for private sector infrastructure projects in Sub-Saharan Africa. EAIF aims to address the market gap created by the high interest / short tenor loans provided by commercial banks in the region, which are typically not suitable for infrastructure financing. Coupled with the access to private sector know-how, EAIF provides a unique solution to the need for long term debt financing for infrastructure development in the region. It operates on private sector commercial principles and thereby demonstrates the viability of long-term commercial lending into Sub-Saharan Africa.
- **GuarantCo Ltd. (GuarantCo)** is a local currency guarantee vehicle that is designed to mitigate credit risks for local currency financing of infrastructure. Many infrastructure projects derive most of their revenues in local currency, making hard debt funding inappropriate. However, financing by local institutional investors is often not regarded as suitably creditworthy for infrastructure project financing, with institutional investors often lacking the capacity to evaluate creditworthiness of projects and to price long term securities. In response to this market failure, GuarantCo offers partial guarantees on private and public sector debt issued for infrastructure projects. These serve as credit enhancements to facilitate local debt markets, mitigating credit risks for local lenders and investors. GuarantCo's key objectives are to encourage domestic financing of infrastructure services and promote local capital market development.

In addition to these PIDG PFFs, as mentioned above, **InfraCo Asia** will also function as a project financing vehicle, providing equity and quasi-equity investment products for infrastructure projects. The PIDG is also currently investigating the possibility of setting up another PFF, a **Currency Liquidity Facility (CLF)**, which is a financial product

designed to mitigate foreign exchange risk. It will be a standby, subordinated, revolving loan that provides funds to a project if, and only to the extent that, there is a shortfall in debt service caused by real currency depreciation beyond a pre-agreed band.

2.1.3. Funding access to infrastructure services for the poor

A major problem with infrastructure development in developing countries is the low ability to pay for the use of infrastructure services. This inhibits full cost recovery tariffs and hence sustainability of the infrastructure services. As a result, provision of infrastructure services at the desired levels of consumption, often needs to be supported by subsidies. OBA subsidies are one way of addressing this gap, by providing performance-based subsidies in which suppliers are only paid the subsidy when they have verifiably delivered specified outputs. Performance-based contracts are therefore employed to allocate explicit, credible and sustainable subsidies to deliver basic services to the poor, allowing private operators to mobilise much-needed commercial funding, and improve aid effectiveness.

A number of PIDG members, both through and outside of the PIDG have supported and / or developed two initiatives to support OBA subsidies in infrastructure development:

- The **Global Partnership for Output-Based Aid (GPOBA)** is a PIDG Affiliated Programme that seeks to encourage the use of OBA approaches to the delivery of infrastructure, linking subsidy payments to service providers with the actual delivery of 'outputs' to customers.
- **TAF** has also recently established an OBA window, focusing on providing grants for studies, technical assistance and training as well as subsidising initial fees and user charges or contributions to capital expenditure to reduce downstream cost recovery charges.

2.2. Developing a framework to analyse the PIDG facilities

In order to compare and contrast the typical interventions of the PIDG facilities with those of other IFIs we have sought to develop a simple framework. This comprises two main dimensions: first, the type of infrastructure project cycle activity supported; and second, the type of infrastructure project beneficiary and whether this might be seen as largely public, private or public-private partnership (PPP) in nature.

2.2.1. The infrastructure project cycle

To simplify the analysis we have divided the infrastructure project cycle into four broad phases:⁶

- **Project development**, comprising:
 - *Developing the enabling environment*, involving designing enabling legislation and regulatory approaches, capacity and consensus building within the government.
 - *Project definition* or early stage concept design work that is needed before the full feasibility phase, as it defines the project's parameters.
 - *Feasibility assessment* in terms of organisational, financial, technical, social, environmental and other aspects of the project.
 - *Project structuring* involving the development of an appropriate commercial and technical structure for the project, crucial not only for attracting finance, but also for attracting the right mix of finance.
 - *Transaction support*, entailing moving the project on from the planning to the implementation stage.
- **Project financing**. Financing of an infrastructure project refers to the provision of funds to build / construct the infrastructure service. Depending on the type of project, international

financing institutions may provide different types of financial products. For private infrastructure projects (and privately managed PPPs), financial products offered include equity (and quasi equity) financing as well as debt financing on commercial terms. For public projects (and publicly managed PPPs), donor financing offered includes mainly concessional loans, development credits and grants.

- **Project funding.** Funding of an infrastructure project refers to the payments for the use of the infrastructure service. Funding of a project may involve contributions from both the public and private sector depending on the extent to which the state is subsidising the use of the infrastructure services and the extent of contribution from user charges by the users of the infrastructure service.
- **Project operation.** This is the final stage in the project cycle and relates to operating the infrastructure. Depending on the type of project, it may be managed by the Government, or by a private sector operator.

Each of the above is an area for potential donor involvement.

2.2.2. The public – private spectrum

Based on the simplified stages of the project cycle set out above, at one extreme, a pure **public project** can be characterised as one in which the project development, financing and operation is carried out by the public sector, for instance, by a national utility. Even here, however, a high proportion of project funding can be provided through user charges, although governments may also provide direct subsidies over and above any cross subsidies (noted as ‘mixed’ in Figure 2.2 on p15).

At the other extreme pure **private projects** are characterised as those which are developed, financed and operated by the private sector and funded through user charges.

In between the two extremes **PPP projects** have a mix of both sets of characteristics, wherein both the public and / or the private sector may be involved in each project cycle activity, albeit with the private sector usually being in charge of project operation. Again, funding of the project may be based on user charges and / or subsidies.

Figure 2.2 aims to characterise these two dimensions along the horizontal and vertical axis respectively. The space created provides a simple framework in which to illustrate where different IFIs and the PIDG have focused their efforts.

2.2.3. Mapping out the focus of different types of IFIs

There is an existing architecture of international institutions operating across the project cycle with varying levels of private participation. For simplicity, we have grouped them as follows:

- **Bilateral donors** – that is, grant providers, or highly concessional lenders such as the UK’s Department for International Development (DFID), Japan International Cooperation Agency (JICA), among others.⁷
- **Development banks** – that is, the sovereign financing operations of multi-national and bilateral development banks such as the World Bank IDA and IBRD, the African Development Bank, KfW (German Development Bank), AfD (French Development Bank), among others.
- **Development finance institutions (DFIs)** – including the European bilateral DFIs such as FMO (the Netherlands Development Finance Company), Proparco (the French Development Company), etc and the private sector operations of the main development banks including the International Finance Corporation (IFC).

Figure 2.3 depicts what is seen as being the main scope of operations of these institutions within the framework developed.

Figure 2.2: Nature of infrastructure projects by stage of project cycle

| Project cycle | Public/private Public projects | PPP projects | Private projects |
|---------------------|-----------------------------------|--------------|------------------|
| Project development | Public | Mixed | Private |
| Project financing | Public | Mixed | Private |
| Project funding | Mixed | Mixed | User charges |
| Project operation | Public | Private | Private |

Figure 2.3: International architecture for enabling infrastructure projects – main focus areas

| Project cycle | Public/private Public projects | PPP projects | Private projects |
|---------------------|-----------------------------------|--------------|------------------|
| Project development | Public | Mixed | Private |
| Project financing | Public | Mixed | Private |
| Project funding | Mixed | Mixed | User charges |
| Project operation | Public | Private | Private |
| Development Agency | Development bank | Bi-lateral | DFI |

Bilateral donors

Bilateral donors tend to provide support largely to public sector projects, although some have ventured directly (i.e. without going through PIDG or an IFI) into PPP support. This has deepened with an increasing focus on social rather than economic infrastructure projects. The water sector – which is largely public sector owned and controlled – is a particular beneficiary of bilateral support. Because of the specialist skills required in developing PPP approaches, there has been an increasing tendency for the bilaterals to work through their DFIs or through one of the IFIs (or indeed PIDG) in these areas.

Development banks

Development banks have historically focused on public sector infrastructure projects, providing technical assistance / advisory services / loan finance to government departments and publicly-owned utilities responsible for infrastructure development (as against assuming the role of a project developer).

They have become more interested in PPP type solutions as their governing policies have also sought to shift financing resources away from economic infrastructure towards the social sectors. Indeed, their remit has been the corollary of this in terms of developing policies to attract private finance into the projects that they have vacated. More recently, however, the need for public sector participation in PPPs (typically through governments on-lending development bank loans to projects) has been increasingly recognised. This, combined with a growing interest in sub-sovereign / municipal funding and project financing, has brought the development banks increasingly into this new space.⁸

DFIs

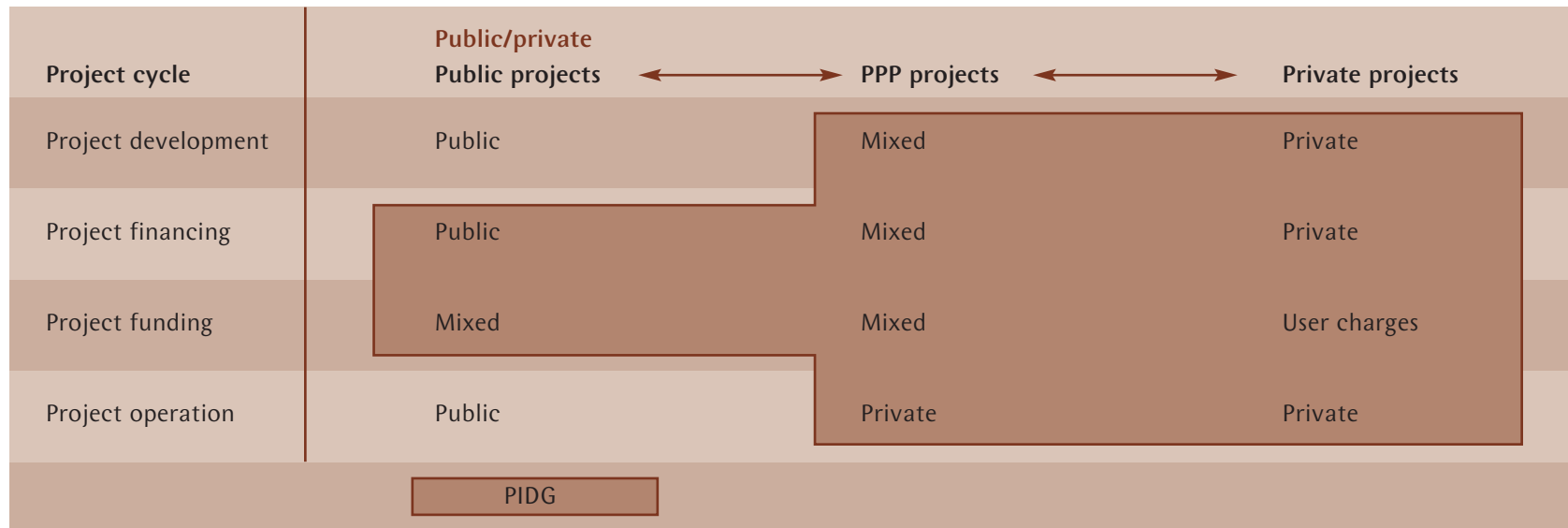
The DFIs focus on the financing of private and PPP infrastructure projects, usually at near-commercial terms. DFIs are donor-backed commercial investors who acquire both equity (i.e. rights over a project through shareholding with associated financing risks) and issue private sector loans, which are priced according to the full range of risks facing a project. They also generally provide quasi-equity products and subordinated debt, and tend to be less risk-averse than fully private operators. They typically provide loans to projects directly and / or take an equity stake and thus take on project risks. DFIs aim to leverage private sector finance at the project level. They take project political risks and do not require sovereign guarantees.

2.2.4. The role of the PIDG facilities in the international architecture

The scope of the PIDG facilities can be mapped into the framework described above, and is shown in Figure 2.4. As can be seen from the figure, the range of PIDG facilities covers a substantial ground, mostly focused on PPP and private infrastructure projects.

The PIDG PDFs provide resources for particular aspects of project development. InfraCo is a project development company that assumes the role of a project sponsor and takes the project forward until financial close. InfraCo can also be involved with project operations by retaining a minority stake at financial close when selling to investors. InfraCo Asia will increase PIDG involvement in downstream project operations by holding longer term (patient) equity in the projects it develops. DevCo provides resources to increase managerial capacity, primarily to public sector clients looking to put in place an infrastructure PPP. TAF provides early

Figure 2.4: The comparative role of the PIDG facilities



stage resources for project feasibility to private infrastructure projects.⁹ Note that PIDG activities have not focused on developing the context and enabling environment for infrastructure projects where players such as the PPIAF are active.

The PIDG PFFs, EAIF and GuarantCo, provide / facilitate long-term debt financing for infrastructure projects. While EAIF is focused on private sector projects and even PPPs, GuarantCo can offer guarantees to public sector clients as well. The CLF will provide currency guarantees primarily for private projects.

Finally, GPOBA and TAF (Window 3) provide funding for projects. While GPOBA provides funding for public, PPP and private projects,

TAF can be expected to provide funding mostly for PPP and private projects as it is linked to the other PIDG facility operations.

Thus, on balance, the main focus of the PIDG facilities is on PPPs and private sector projects, making their foot-print most similar to that of the DFIs. However, unlike the DFIs, rather than just the provision of financing, the PIDG has a much greater emphasis on project development activities, and through GPOBA and the TAF, on project funding. Thus, in comparison with other donor approaches, the PIDG facilities provide support for a range of activities in the project cycle. Moreover, by virtue of being housed under the same umbrella organisation, there is considerable potential for each initiative to complement the activities of another.

2.3. Characteristics of the PIDG approach

There are a number of characteristics of the PIDG approach which make it different to others, particularly the manner in which the PIDG donors have elected to use their grant contributions. Whereas each type of IFI has its specific strengths – for instance the World Bank Group’s credibility in bringing a high degree of transparency to a transaction – the availability of grant money has enabled the PIDG facilities to take risks that others cannot. These include the provision of high risk, early stage development capital and the ability of donor monies to be subordinated to other monies within fund structures. As a result, the PIDG has been able to leverage private resources to a considerable extent. PIDG members have also shown themselves to be open to a wide range of innovative ideas, many of them coming from the market as a result of an increased dialogue with the private sector partners.

Some examples of these characteristics are set out below.

2.3.1. Creating innovative new initiatives

Throughout its history, the PIDG has been willing to listen to the market and to attempt some highly innovative approaches to help advance private sector investment in the infrastructure of the poorer developing countries. These include:

- *Subordinating donor equity – as in the case of EAIF – to leverage DFI subordinated debt and commercial senior debt.* Whilst such a financial structure is common to individual project financing and certain capital market products, to our knowledge this approach has never been used within an infrastructure fund structure (or at least a donor supported one). A refinancing after the initial three years of operation allowed an even greater amount of senior debt to be raised (taking the Fund from US\$305 million to US\$365 million).

- *Recognising the importance of the project developer role - as distinct from that of a transactions advisor.* Whilst many donors are increasingly recognising the importance of project development and transaction support, they tend to conclude that the government is the principal and that it requires advisory support. PIDG was the first to support the creation of an infrastructure project development company (InfraCo) which, like the private sector, acts as the principal in a project. Arguably, InfraCo’s project developers are better placed to understand what is required to make a project work than are advisors, especially with regard to greenfield opportunities.
- *Recognising the importance of the currency mismatches and the different options through which the problem might be addressed.* The PIDG recognises the need to enhance local currency financing of infrastructure projects and aims to foster this through the setting up of GuarantCo – a facility that provides guarantees for local currency debt issuance by private, municipal and parastatal entities, thereby enhancing credit. PIDG also recognises that an increase in and issuance of local currency instruments will potentially play an important role in furthering the development of domestic credit and capital markets. In addition, the PIDG is presently in the process of developing another facility – the CLF – which will help mitigate foreign exchange risk in an efficient manner.

Finally, from an early stage, the PIDG has recognised the importance of OBA as a means of helping to address the affordability issue, hence the link with GPOBA and the creation of an OBA Window in the TAF.

2.3.2. Relatively “hands-off” approach to private sector management

To varying degrees, all of the PIDG facilities, with the exception of the Affiliated Programmes (i.e. DevCo and GPOBA), are

managed by the private sector. EAIF, GuarantCo and InfraCo have all been tendered out to specialist management companies; however, as private companies, they have corporate Boards with a responsibility for ensuring that the management companies operate in the interests of their PIDG sponsors.¹⁰ The Board members are not typically donors, but rather professionals with a detailed understanding and experience of the operations of the underlying vehicles.

On the whole, the PIDG has traditionally pursued a relatively hands-off approach, particularly in terms of leaving the detailed financing and development risk-taking decisions involved in projects to the management teams and Boards best placed to do so – the PIDG donors, as interested shareholders, have instead rightly assumed the role of providing high-level strategic guidance for the initiative as a whole.

This approach is somewhat different from the more standard donor approach seen in practice, where the donor members are more fully engaged, for example, seeking Board representation, often by individuals who lack the necessary skills to perform the role effectively. The more hands-off PIDG approach represents an allocation of responsibility according to who is best placed to deliver strategic (i.e. donors) and technical (i.e. private sector facility managers and Boards) advice and has been possible because of the strong governance arrangements – with contractual underpinnings – in the PIDG structure which serve to maintain an underlying discipline for all participants.

Notwithstanding this, over the years there would appear to have been increasing pressure on PIDG and the facilities, arising from policy commitments within the participating development agencies, to increasingly demonstrate the full range of developmental outcomes that the projects supported by the facilities achieve, many linked to the MDGs. Whilst this issue is discussed at length in later

sections, a demonstration of the shared objectives of the PIDG facilities has been the willingness of their management teams to respond to these requirements, which often go well beyond what they were strictly contracted to report.¹¹

2.3.3. Leveraging of resources

The PIDG donors have managed to leverage their resources to a considerable extent. Leveraging of resources has been achieved at three levels:

- *By forming a multi-donor alliance.* The PIDG donors have pooled their resources to form a multi-donor alliance, expanding their operations and assistance across a wider set of investments than would have been possible with each donor acting individually.
- *By leveraging financing from other commercial sources.* This is particularly the case for EAIF, as discussed above, wherein donor equity has managed to bring in additional senior and subordinated debt from commercial lenders and DFIs – for PIDG equity of US\$100 million, additional financing of US\$265 million has been obtained from these sources. GuarantCo will also soon be in a position to leverage its own guarantee capacity.
- *By being a part of a larger financial plan in a project.* The PIDG facilities fund and support projects as a part of a syndicate with additional financiers also contributing to the project. For example, as of 2007, EAIF financing of US\$384.5 million in infrastructure projects have led to estimated private sector commitments of US\$5.4 billion.¹² For the PIDG as a whole, total estimated private sector investment commitments per dollar of actual PIDG investments is in the region of 30:1.

2.3.4. Effective use of development aid

The PIDG facilities serve to meet the aid effectiveness priorities by virtue of the facilities being able to re-use / recycle their funds to support increasing numbers of projects over time. The PIDG facilities have been designed to function in a self-sustaining manner in the long run. Also, pooling of resources by the donor members fosters greater value for money. As a result, the development funding provided is much more effective.

2.4. Impact of the PIDG approach

As yet, it is too early to show the full impact of the PIDG approach on infrastructure provision in terms of outcomes, particularly on any comparative basis, given the long gestation lags for infrastructure development. However, in order to ensure a continued and improving pro-poor focus of the facilities, the PIDG has implemented a comprehensive monitoring and evaluation framework wherein all interventions are continuously assessed in terms of their current and expected development impact (some of the key results are presented in Section 1.1. above).¹³

In addition, from published data it is possible to show how well the consolidated portfolio of PIDG activities compares to those of other IFIs, in terms of country focus. This can be shown for both different country income levels and different levels of country riskiness.

2.4.1. Country income levels

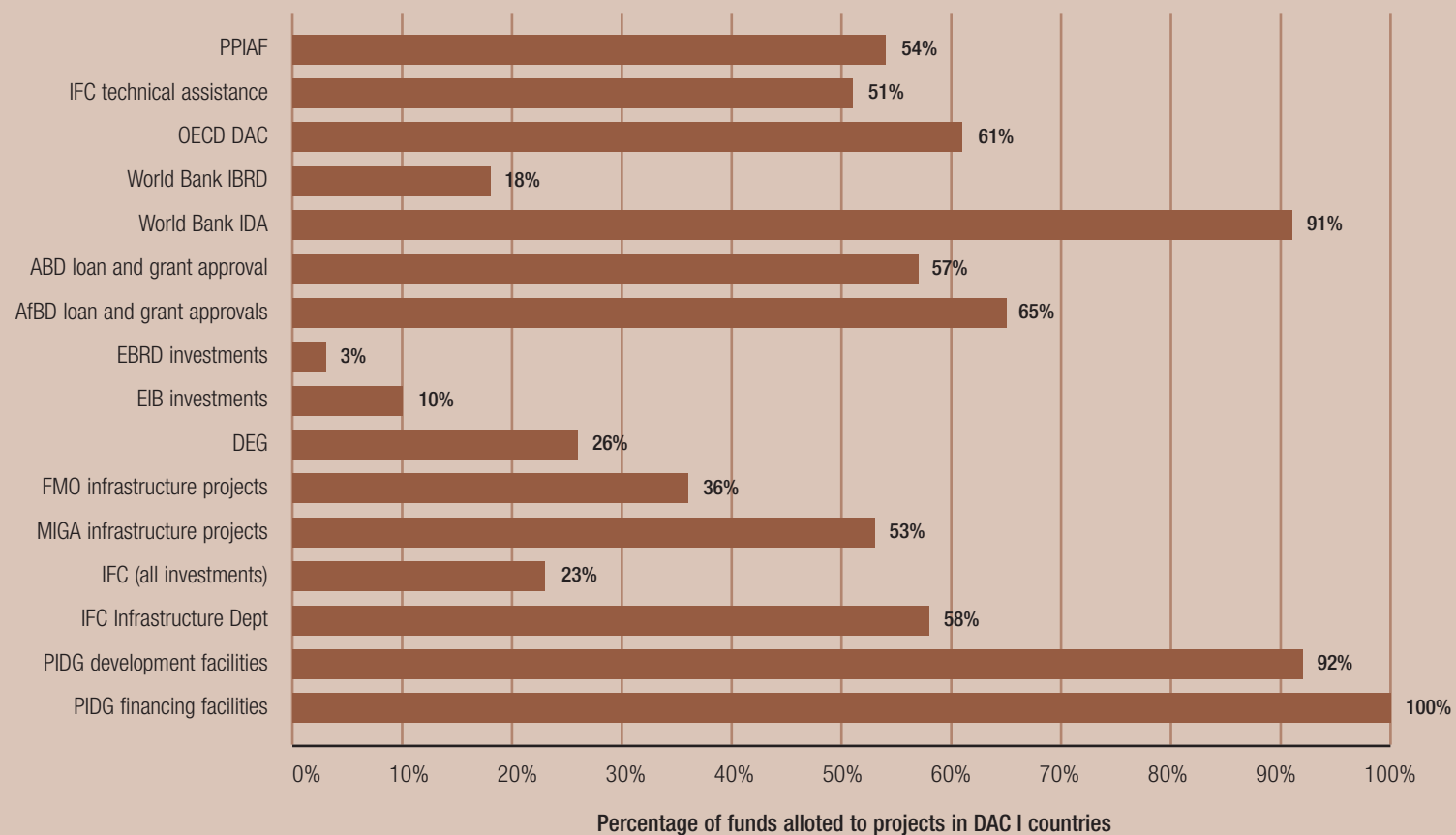
It has been an aim of the PIDG facilities to concentrate their project development and financing activities in the poorest countries, where they have sought to mobilise private sector resources.

As shown in Figure 2.5, all of the investments made by PIDG project financing facilities up to 2007 have been in the poorest group of countries, i.e. those in which per capita income in 2004 was less than US\$825 (DAC I). Similarly, the project development vehicles have disbursed 92% of funds in these countries. Note that PIDG facilities operate mainly in both DAC I and II countries.

Thus, in comparison with a range of other IFIs – particularly DFIs – the PIDG has been extremely successful in targeting poor countries. For example, 58% of IFC investments in infrastructure have been in DAC I countries, whilst the comparative figure for FMO energy and infrastructure is 36%. It is important to note in these comparisons that the PIDG is a relatively new organisation with a small number of projects as compared to many of the other organisations considered. Also some of the donor organisations have specifically bought into the PIDG to strengthen their attention on DAC I and II countries.

As a further illustration, around 87% of the PIDG financing vehicle resources were committed in countries where per capita income is less than US\$500 annually.¹⁴ This compares with less than 18% for the IFC's infrastructure department. The PIDG facilities also compare favourably with other international project development and financing bodies such as PPIAF¹⁵, MIGA and the EIB.

Figure 2.5: Percentage of funds employed in countries in the DAC 1 list (first two columns)¹⁶



2.4.2. Country risk ratings

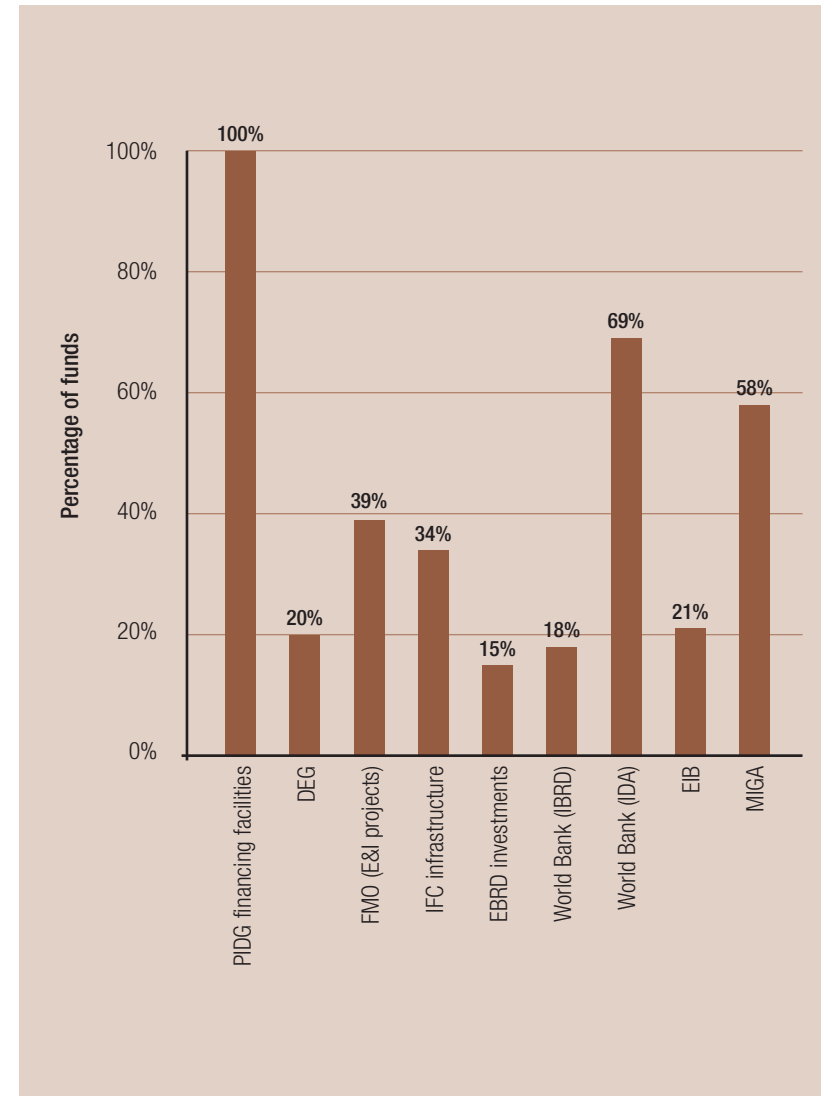
An alternative approach is to consider the riskiness of countries. A comparison of the country focus of PIDG activities, as compared to other donor initiatives in terms of sovereign credit risks, also reveals interesting results.

Figure 2.6 shows the percentage of funds for different financing and development vehicles that have been allocated to projects in countries where the export credit rating by OECD is 6, 7 or unclassified (i.e. high risk) The figure shows that all funds employed by the PIDG financing vehicles were invested in the highest risk countries.

Just over a third of investments made by the IFC's infrastructure department were in countries rated 6,7 or unclassified, while this was less than 40% for FMO's energy and infrastructure investments. Only MIGA, which provides political risk insurance, assumes high risk projects, with nearly three-fifths of gross guarantee financing in countries rated 6, 7 or unrated.¹⁷

Similarly, three-quarters of the funds employed by the PIDG project development facilities were in countries rated 4, 5, 6 or 7 (not shown in the figure above). Facilities such as PPIAF and the IFC's technical assistance fund are willing to take on more risk than many of the financing institutions, but still operate in countries that are far less risky (in terms of the financial environment) relative to the PIDG's development facilities.

Figure 2.6: Percentage of funds allotted to projects in countries whose export credit rating by the OECD is 6,7 or unclassified (i.e. high risk)¹⁸



3

PIDG - High level structure and governance

This section provides a background to the PIDG and discusses the strategic approach that defines the initiative. The aims and objectives of the PIDG are described, as well as the salient features of its structure, governance and operational framework. The section concludes by considering the key benefits of the PIDG approach as well as some of the challenges it has faced.

3.1. Aims and objectives

As set out previously, the PIDG is a multi-donor organisation, constituted in 2002, with the aim of encouraging private infrastructure investment in developing countries to contribute to economic growth and poverty reduction. It seeks to increase access to new and improved infrastructure, with a focus on sustainable pro-poor economic growth. Central to the activities of the PIDG is the belief that infrastructure is important for sustainable development and the reduction of poverty, and that private sector investment is essential to increasing the provision of infrastructure services.

The mission, objectives and targets of the PIDG are summarised in Figure 3.1.

The following sub-sections describe the structural and operational framework of the PIDG.

3.2. Structure and governance

The PIDG is an alliance of a number of donors, partnering together to catalyse private sector investment in infrastructure.¹⁹ The PIDG structure

Figure 3.1: PIDG mission, objectives and targets²⁰

| | |
|-----------------------------|--|
| Mission | “The Private Infrastructure Development Group is a coalition of donors mobilising private sector investment to help developing countries provide the infrastructure vital to boost their economic development and combat poverty.” |
| Objectives | <ol style="list-style-type: none"> 1. Enhanced provision of sustainable infrastructure services (quality and quantity). 2. Increased numbers of poor men and women able to access and use infrastructure services. 3. Increased flows of local, regional and international investor capital and expertise to infrastructure. 4. Transfer of skills at a local level and building of domestic capacity to harness private participation in infrastructure for the benefit of the country and especially the poor. 5. Pro-poor economic growth. |
| Targets (2007- 2009) | <ol style="list-style-type: none"> 1. Increase private investment by US\$1.7bn per year in poorer developing countries by end 2009. 2. At least 75% of private sector investment under PIDG to be in DAC I and II countries. 3. Increase availability/improve quality of infrastructure services in poorer developing countries, by at least 3,500,000 people per year by end 2009 4. Fiscal impact of US\$500m a year comprising US\$150m per year of up-front government fees and US\$350m of avoided government subsidies/ concession fees/ additional taxes. |

comprises a Governing Council, a Programme Management Unit (PMU), a PIDG Trust, and the PIDG facilities and Affiliated Programmes. Figure 3.2 provides a simplified diagrammatic representation of how these several actors fit into the overall PIDG structure.

In the following sections of this chapter, we present more details on:

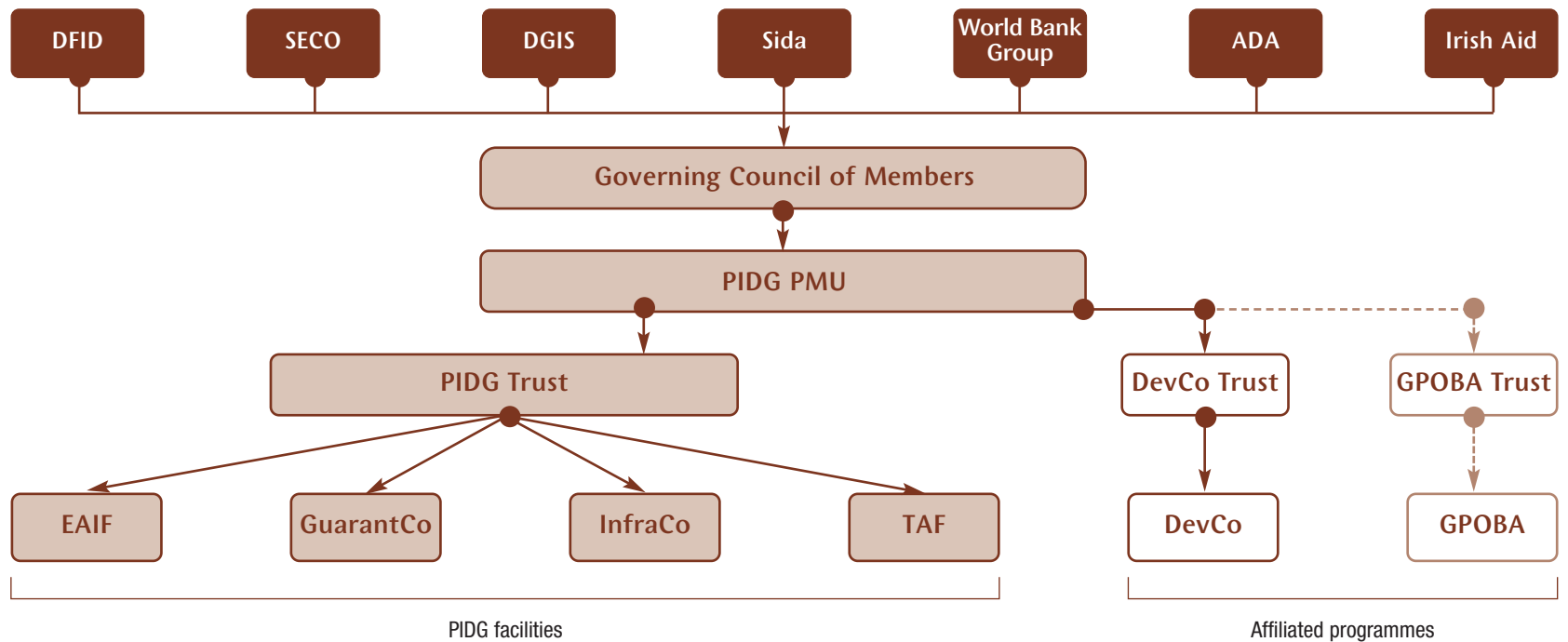
- the PIDG Governing Council;
- the PIDG Trust; and
- the PMU.

The PIDG facilities and Affiliated Programmes are discussed in detail in Section 4.

3.2.1. PIDG Governing Council

The Governing Council consists of a representative of each donor member of the PIDG and is the overall decision making body for the PIDG. It provides high-level strategic guidance for the PIDG. The Governing Council also takes decisions on the establishment of new facilities as well as on the inclusion of additional donor members to the group.²²

Figure 3.2: The PIDG structure²¹



Each member has one vote on the Governing Council. Decision making amongst the Governing Council members is consensus based and all decisions are unanimous, although abstentions are allowed.

The Governing Council meets twice yearly, wherein members review current and potential projects of the facilities, review the performance of the facilities including their developmental impact, assess and examine present and further links with the Affiliated Programmes as well as consider strategic and administrative issues. Each meeting comprises a closed session for PIDG members only, as well as an open session to involve the facility managers and some observers. PIDG donor members host the meetings in rotation, with the host member chairing the meeting and the Governing Council for a period of six months until the next meeting.

3.2.2. PIDG Trust

The PIDG is not a legal entity in its own right and therefore performs many of its functions through the PIDG Trust. The PIDG Trust serves as the vehicle for investment in the PIDG facilities (EAIF, GuarantCo, InfraCo and TAF) and is used to channel the donor funds to these facilities. In addition, the Affiliated Programmes (DevCo and GPOBA) have their own separate Trust Funds within the World Bank Group, where the PIDG and other donors contribute their funds.²³

The PIDG Trust enters into other contractual arrangements on behalf of the PIDG. The role of the Trust also extends to reviewing and executing grant and loan agreements (as well as contracts for services with consultants), coordinating and authorising payments, producing annual audited financial statements, amongst other functions. The PIDG Trust was established by a Declaration of Trust dated 1 December 2001 (as amended by an Amended and Restated declaration of Trust dated 14 March 2003). At present, the Trust is located in

Mauritius²⁴ and managed by three experienced trustees – with the principal trustee being UK based SG Hambros Trust Company Ltd, and the other two being Minimax Ltd and Multiconsult Trustees Ltd, which are Mauritian based companies. The Trustees act jointly for, and on behalf of the Trust. The Trust is administered by the principal trustee, and is therefore resident in the UK for tax purposes.²⁵

3.2.3. The PIDG PMU

The PMU is the central pivot point of the PIDG operations. It manages the relationship between the different PIDG entities and between the entities and the donors, and is the point of contact for the PIDG Trust. It is also responsible for taking forward the development of new PIDG facilities to the point where a Board is appointed to take up the responsibility of facility management. In short, the PMU is responsible for the day-to-day management and operation of the PIDG, balancing the different needs and opinions of the donors and the PIDG facility managers.

The principal operations of the PMU are to:

- Manage the relationship between the individual facilities and the PIDG.
- Support the long term objectives of the PIDG and make suggestions on procedures and systems to improve and facilitate the governance and management of the PIDG.
- Manage the development of any new facility.
- Assist the PIDG Trust with funding and investment matters.
- Coordinate reviews and evaluations of the PIDG programmes.
- Serve as the public face of the PIDG, providing information as appropriate.

Thus, the PMU is integral to the PIDG, managing and administering its operations.

The services of the PMU have been competitively tendered, with the Governing Council appointing a PMU for a period of four years.²⁶ The PMU structure is lean, with the current unit comprising a Programme Manager, an Assistant Programme Manager, a Development Adviser (part-time) and support staff. The PIDG often enters into consultancy arrangements with external consultants to support its responsibilities.

3.2.4. PIDG facilities and Affiliated Programmes

The PIDG implements its objectives through its project financing and development facilities. Details on the facilities, including their financial and governance structures, are discussed in Section 4 below.

3.3. Operations

The PMU is responsible for coordinating the operations of the PIDG. The PMU manages arrangements between members, the PIDG Trust, projects, facilities and Affiliated Programmes, as well as provides secretariat services to the Governing Council.

3.4. Key benefits and challenges

In this section we begin by setting out some of the key benefits of the PIDG to its members, before setting out some of the challenges that the PIDG has faced in its development. These reflect the views of different PIDG stakeholders.

3.4.1. Key benefits

Economies of scale

The PIDG, as a multi-donor alliance, enables its members to present themselves as a united front to communicate and engage

not only with the private sector, but also with other IFIs. It allows the PIDG donors to expand their operations and support a wider scale of investments than would have been possible through their individual resources and expertise, especially as regards some of PIDG's smaller members. With the pooled resources of the donors, PIDG can achieve a greater developmental impact, better coordination and lower transactions costs as compared to each donor acting individually.

Harmonisation of efforts

The coordination of donor activities through the PIDG enables a harmonisation of efforts. PIDG donors can work together to promote private sector participation in infrastructure in developing countries. The alliance avoids duplication of efforts and also fosters the sharing of lessons amongst different donors.

Provision of untied aid

The PIDG provides its donors a mode for providing untied aid for development. Whereas following the OECD recommendation, most bilateral donors are already decreasing their levels of tied aid, this is further enhanced through their involvement with the PIDG.

Traditionally, as represented in Figure 2.3 in Chapter 2, bilateral donors have supported public infrastructure projects, with some assistance for PPP projects. Working through the PIDG, the bilateral donors have now been able to support pure private and PPP projects to a greater extent. As a result, the donors have been able to expand their infrastructure portfolios to also cover poorer and more risky environments.

Non bureaucratic and light management by the donors

The PIDG approach has not been to set up an international institution to develop and manage its operations, but instead to work through a

relatively light structure, with the donor members providing strategic guidance to the initiative and the facilities and their Boards being responsible for day to day operations.

This presents several benefits for the donor members as well as the PIDG operations as a whole. The PIDG donor members can focus on key strategic issues as against providing extensive managerial support – an approach which is a first of its kind for many bilateral donors who have previously closely monitored their investments and assistance in projects. This approach positively impacts PIDG operations through reduced bureaucracy and greater efficiency. The non bureaucratic structure has enabled the PIDG to work efficiently with the private sector.

However, it also needs to be noted that the light management structure by the donors may present certain challenges as well, for example in coordinating donor interests and priorities. This is discussed further below in Section 3.4.2.

The flexibility of the Trust structure

The Trust structure that has been adopted by the PIDG offers a number of benefits:

- First, it provides a mechanism for donors to invest in private companies without directly holding the equity themselves. A Trust structure was chosen by the PIDG because it offers an effective approach, through which donors are able to delegate fiduciary responsibility for the oversight of the investment activities to the PIDG Trust and are protected from legal liability in relation to the activities of the PIDG.
- Second, it enables PIDG members to fund different PIDG initiatives at different points in time: it is not necessary that all PIDG donors have to contribute to all project facilities, with the flexibility of

incorporating additional members as the need may arise. As a result, PIDG donors can supply their funding in a flexible manner, supporting initiatives that closely meet their own individual objectives. The Trust structure allows the donors to invest in a group of companies (through the Trust) and also have some say in the companies in the group in which they do not invest.

- Third, the trustees also serve as an independent check that the PIDG member's funds are disbursed only if the request meets the contractual conditions.
- Fourth, while the setting up of the Trust involved some initial expenses and knowledge development, in the long run the Trust has proved to be a cost effective mechanism with each new facility being able to use the Trust structure as it is developed.
- Finally, the Trust structure is more cost efficient than setting up a new international organisation, which would have been time consuming and bureaucratic.

The PMU offers a cost effective and efficient option for its services

As discussed above, the PMU is effectively the arms and legs of the PIDG. It comprises a small team of experts, representing good value for money – in 2006 the annual running costs of the PMU was 0.2% of funds under management, and this percentage is falling as the facilities grow. As the PIDG develops, the PMU is also growing to incorporate additional roles and monitoring development benefits of the PIDG facilities.

The fact that the management contract for the PMU is competitively tendered, provides greater independence and flexibility in its operations. However, this may also lead to teething problems at the end of each contract period, if a new PMU is constituted. There is also a question of the loss of institutional memory, which largely rests in the PMU, given the fairly rapid turnover of donor representatives for the PIDG.

3.4.2. Key challenges

Despite the benefits outlined above, the PIDG has also faced a number of issues which present a challenge for management and operations.

Managing differences between the individual donors

The flipside of scale benefits is that a multi-donor partnership also presents certain challenges. The donor members that comprise the PIDG differ considerably in size, budgets available, staff capabilities and skills. Some have largely outsourced their PSP infrastructure work to the PIDG, whereas others have substantial in-house capability, in particular the World Bank / IFC. PIDG members also vary considerably in their level of experience with PSP solutions. These differences have impacted upon the ease of discussions between donors. The PIDG PMU plays a crucial role in balancing these differences between donors in order to ensure the smooth functioning of the initiative.

Insufficient understanding of the details of infrastructure PPPs and project financing and development amongst donors

Building on the above mentioned challenge, and given the non-financial background of some of the donor representatives, a key issue for the PIDG has been a lack of adequate understanding by some PIDG donors of private participation in infrastructure development, for example in terms of specific issues in the project development cycle, or the challenges of structuring infrastructure financing. The strength of the PIDG approach, however, lies in the setting up of facility Boards to provide technical knowledge to the initiatives, to complement the strategic role that the PIDG donors play. In addition, there is a need for the managers of the facilities to be 'user friendly' in helping the donors understand their operations better.

The donor members have also faced challenges in negotiations around the setting up and development of facilities which involve considerable legal and institutional issues. These have not to date been insurmountable, but are very time consuming and at times have stretched the staffing capacity of the PMU.

Balancing individual donor priorities

Despite supporting donor cooperation, each of the donors still has to operate on the back of its own national strategic framework and guidelines. This has the ability to create a whole range of problems which need to be worked around, which do not exist for instance if the countries involved were to work through a multi-lateral where each organisation would necessarily accept the multi-lateral's "rules of the game". Hence, in the case of the PIDG material differences can arise over such things as:

- acceptable remuneration and consulting rates for management teams and directors;
- focus countries and sectors for assistance;
- unease over perceived national dominances; and
- the level and type of information required from the individual PIDG facilities and the assumed level of donor oversight required.

In dealing with these issues, a further challenge is to ensure that PIDG management retains as light a touch as possible. This is because there is a natural tendency to move towards a more formal institutional structure, with an agreed set of management guidelines. Obviously, pursuing such an approach would increase the cost base substantively and, to date, the PIDG has managed to avoid over-formalising arrangements, with donor members showing surprising flexibility in order to maintain a consensus approach.

Issues with staff turnover and continuity within donors

Given the length of time that the donors are involved in the PIDG and requirements for donor staff rotation, there has to be regular 'induction' for new staff by the PMU. To date, perhaps the main constant knowledge base is the PMU, which itself is due to be newly procured shortly.

Increasing obligations on the PIDG facilities

As mentioned earlier, the amount of information requested from the facility managers and Boards of the PIDG facilities has increased over recent years, especially in order to demonstrate the specific developmental impacts of the projects being supported. This has, at times, presented additional work for the facility managers who are already working towards a challenging task. For example, facility managers are now required to fill in detailed monitoring and evaluation forms for each project, specifically highlighting the 'direct' impacts on poverty. Although, in the spirit of collaboration, the facility managers have to date provided the information sought on the poverty impact of their projects, the desire for information from donor sponsors needs to be balanced (and indeed disciplined), such that it does not become overly burdensome and distract from the main work of the facilities.

In addition to reporting demands, there may be additional influence from donors for meeting their broader objectives and responding to changes in policy. This may put pressure on the facility to serve multiple objectives for which it may not be suited. Again, the pressures to demonstrate direct pro-poor as opposed to indirect ones is perhaps an example of this. However, it is important to note that the facilities are to a degree insulated from these pressures (as compared to a direct donor intervention) by virtue of being privately managed and having an independent Board of Directors.

4

Designing, implementing and operating the PIDG facilities

In this section, we focus on the individual PIDG facilities. In doing so, we consider the approach to their design, implementation and operations, particularly as regards their relationship with the PIDG. As with the previous section, after setting out these background facts, we consider the benefits of the approach and the challenges that have been faced, as perceived by the different stakeholders involved.

4.1. Design and implementation

From its early days, the PIDG has been aware of the range of different barriers that exist to successful infrastructure PSP in developing countries. This has resulted in the creation of the PIDG facilities to address these problems.

Excluding the Affiliated Programmes, the PIDG facilities have typically been developed through a process involving initial concept development / pre-feasibility assessment, feasibility, including market testing, and subsequently the procurement of appropriate management services from the market. The development of each facility has therefore been fairly thorough and detailed in order to develop an initiative that meets the needs of the market. Independent consultants, with knowledge and experience of the private sector, have been involved in several aspects of the feasibility and design stages of a number of these facilities.

Table 4.1 below elucidates who has been responsible for each development phase and implementation of the PIDG facilities,

Affiliated Programmes and the facilities that are currently in development. As shown in the table, there has been considerable variation in terms of how the different appraisals have been undertaken, with some being led by individual PIDG members, with consultants for some exercises being procured through the PPIAF. In addition, some of the feasibility assessments have not been as detailed compared to others – for example, the EAIF feasibility has been much more extensive than that for TAF.

Note that while at present a number of donors have invested in each facility, this was not the case in the beginning. The strong high level and ministerial support within DFID for many of the initiatives meant that it was often in a position to move more quickly than its development partners, as regards provision of funding. For instance, whilst the design of GuarantCo was jointly funded by DFID and Sida (GuarantCo being initially a Sida concept), DFID was able to commit funding to it more quickly.

Table 4.1 also sets out which teams are managing which facilities. Because of the large amounts of public money involved, the procurement of the private sector managers for EAIF, GuarantCo and InfraCo was carried out through an independent and competitive process, resulting in the selection of an appropriate team for each of these facilities.²⁷ InfraCo Asia is the first facility where establishment and procurement of a management team is being managed by the Board of another facility.²⁸

DevCo and GPOBA, as Affiliated Programmes of the PIDG, are housed within and managed by the IFC/ World Bank and can thus benefit

Table 4.1: Responsibilities for different stages of design and implementation as of end 2007

| Phase | Main responsibility for each development phase and for implementation | | | | | | | |
|------------------------------------|---|------------------------------------|-------------------------------------|--|------------------------------------|---|----------------|------|
| | EAIF | GuarantCo | InfraCo | TAF | DevCo | GPOBA | InfraCo (Asia) | CLF |
| Pre-feasibility | PPIAF | DFID / Sida | DFID | World Bank | PPIAF / IFC | World Bank | PPIAF | PIDG |
| Feasibility | PPIAF | PIDG | DFID | World Bank / PIDG | IFC / PIDG | World Bank / DFID | PIDG/ AsDB | PIDG |
| Procurement of management services | DFID | GuarantCo | InfraCo | PIDG | IFC | World Bank | InfraCo | tbd |
| PIDG member funding operations | DFID DGIS SECO Sida | DFID DGIS (FMO) SECO Sida | DFID DGIS SECO Sida ADA | WB DFID Sida ADA Irish Aid | ADA DFID DGIS Sida IFC | DFID DGIS Sida IFC and other non PIDG donors | DFID | tbd |
| Management teams | Standard Infrastructure Fund Managers (Africa) Ltd | SIFMA | InfraCo Management Services (IMS) | Individual Technical Adviser attached to the PMU | IFC | World Bank | tbd | tbd |
| Tax domicile / location of company | Mauritius | Mauritius | UK | na | na | na | tbd | tbd |

from the wide ranging experience and knowledge of these organisations. There are crucial differences, however, in the structure and governance of these two Affiliated Programmes, which are discussed in the next sub- section.

In the case of DevCo, the PIDG approached the IFC to build on its existing project development operations to give greater emphasis to the development of projects for private sector investments in the poorer developing countries. DevCo was thus an IFC operation that the PIDG bought into and hence is managed and housed within the IFC. GPOBA on the other hand was developed initially by the World Bank, but has subsequently received strong support from some PIDG members.

4.2. Structure and governance

4.2.1. Financing structure

The PIDG facilities and Affiliated Programmes differ considerably in size. Table 4.2 below provides the current size of the facilities as of December 2007.

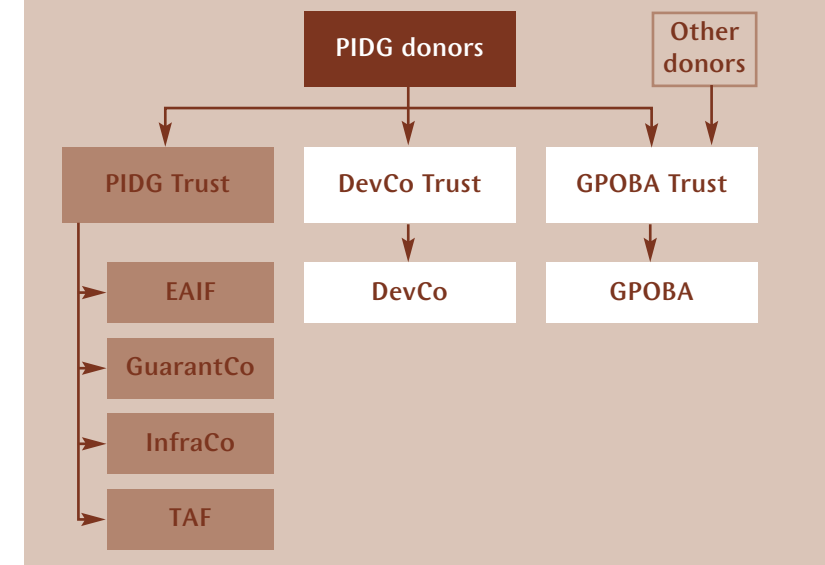
Table 4.2: Size of PIDG facilities

| Facility | Size (US\$ million) |
|-----------|---------------------|
| EAIF | 365.0 |
| GuarantCo | 73.0 |
| InfraCo | 20.0 |
| TAF | 9.7 |
| DevCo | 50.0 |
| GPOBA | 7.5 ²⁹ |

Thus at present, EAIF is a considerably larger facility when compared to the others – however, it is important to note that donor contributions to EAIF in the form of equity represents only US\$100 million of the total fund.

The PIDG project financing and development facilities also differ considerably in terms of the donor member/(s) funding their operations, as listed in Table 4.1 above. In summary, the donor financing element of the PIDG facilities, EAIF, GuarantCo, InfraCo and TAF, are funded through the PIDG Trust, by the donor members that comprise the PIDG. DevCo is also funded exclusively by the PIDG donors, however, the funding is channelled through a separate Trust Fund within the World Bank Group. GPOBA is funded by donors apart from those that comprise the PIDG, again through a separate Trust Fund at the World Bank Group. This is summarised in Figure 4.1 below.

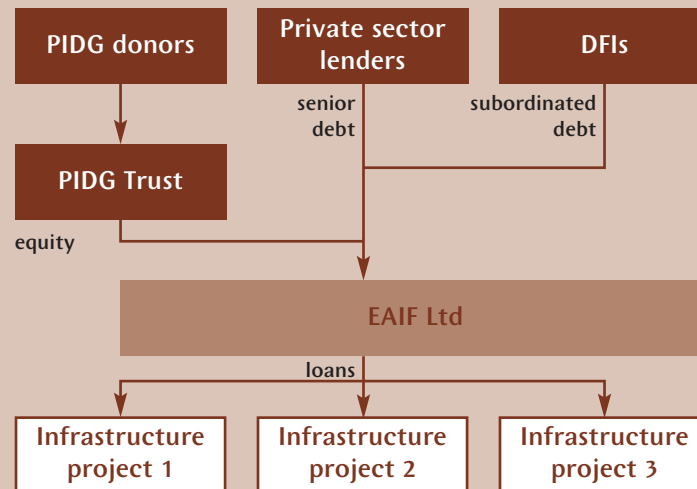
Figure 4.1: Financing of PIDG facilities and Affiliated Programmes by donor organisations



Box 4.1 : EAIF's innovative financing structure

EAIF was set up as a private company with PIDG donors providing equity through the PIDG Trust, commercial private sector lenders providing senior debt and DFIs providing subordinated debt. The figure below sets out this financial structure.

EAIF's financial structure



This structure demonstrates the leverage that PIDG donor equity has obtained by drawing in senior and subordinated debt. US\$100 million of equity from the PIDG donors has to date leveraged US\$180 million of senior debt from private sector lenders and US\$85 million of subordinated debt from DFIs. At US\$365 million, EAIF is US\$60 million larger than at financial close and it is hoped to leverage the initial donor equity even further, such that total fund will be greater than US\$500 million. This has been made possible by EAIF's strong performance which has enabled lenders to increase their exposure to it.

EAIF has a particularly innovative financing structure which is described in Box 4.1. In the case of GuarantCo, PIDG's partner FMO has chosen to invest in GuarantCo directly, rather than through the PIDG Trust. As such, FMO has a seat on the GuarantCo Board, rather than relying on the Trust appointed Directors. As set out in the next section, such an arrangement complicates the governance arrangements, although in future FMO may not be the only development partner that wishes to invest directly, rather than through the PIDG.³⁰

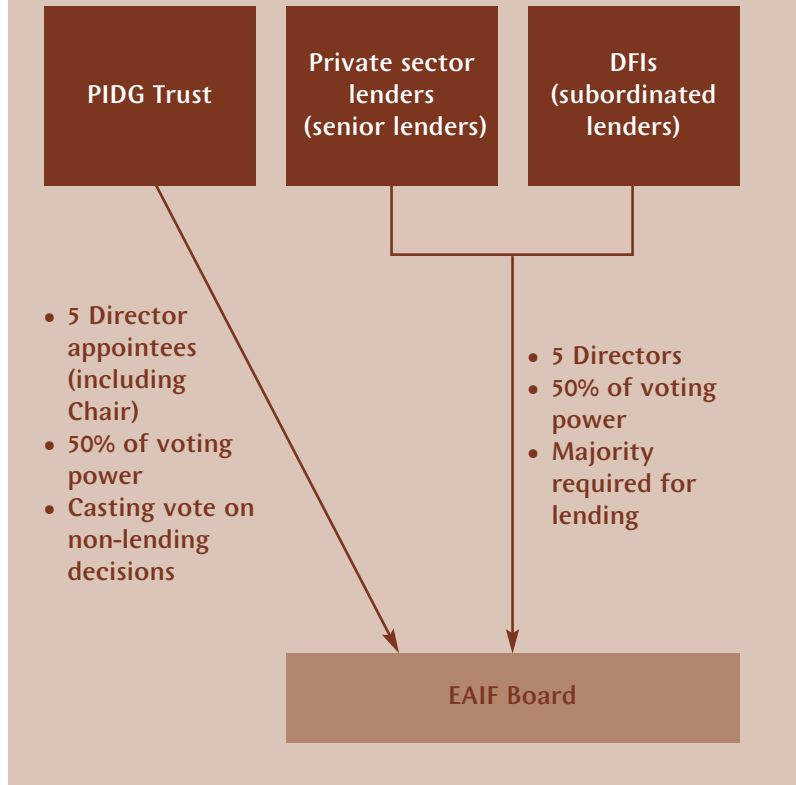
4.2.2. Governance structure

As discussed above, EAIF, GuarantCo and InfraCo have been set up as private companies and therefore each has a Board of Directors who oversee their operations and to whom the management teams report. The Boards of each entity typically comprise individuals with many years experience in the field in question (such as project development). Board members / NEDs have been recruited by responding to a global advertisement, from which they have been short-listed and then selected by a panel. Some Board members have responsibilities on more than one facility Board.

The main rationale for recruiting Board members in this way is so that they have a primary responsibility towards the company, on whose Board they sit, rather than the members of the PIDG. In the case of EAIF, however, the Board also contains representatives of its lenders – which has worked very well, despite the potential conflicts of interest which have had to be disclosed and managed. It has been found that the EAIF Board has acted as one, rather than representatives from banks, DFIs and donor appointments. It is intended that Board members should rotate after three / four years of service.

Box 4.2 depicts the governance structure of the EAIF. The governance structure for GuarantCo and InfraCo works in a similar manner, but with donor members appointing the Board members.

Box 4.2: EAIF's governance structure



With the exception of GuarantCo, all of the owners have channelled their investment through the PIDG Trust and therefore have largely aligned objectives. Whilst FMO has a Board seat on EAIF, this is a special right granted by EAIF's PIDG Trust shareholder in order to increase the transparency of EAIF's operations to its lenders. In the case of GuarantCo, however, its Board representation reflects its shareholder rights. Whilst these are likely to be substantively the same as those of the PIDG Trust, they may not fully be the same,

which means that conflicts of interest may arise from time to time. To the extent they do, however, they will need to be handled in a similar manner to how they are managed by EAIF, where similar issues arise.

All of the PFF's and InfraCo undertake new business and credit decisions based on proposals from management teams. In the case of EAIF, there are formal New Business and Credit Committees (formed from a subset of the Board), also with representation from the main lenders. A loan at Credit Committee by EAIF will not be approved unless the senior lenders approve it. At Board level, however, potential loans, guarantees, etc. can be vetoed by a majority of the Board. One of the considerable achievements of EAIF has been that lenders to EAIF have been prepared to do so without having a formal seat on the Credit Committee.

Box 4.3 depicts the typical decision making structure for an EAIF project. The structure for the approval of a GuarantCo and InfraCo project is also broadly similar.

TAF is managed by a private sector specialist, attached to the PIDG PMU. Decision making within the TAF comprises the TAF manager and the PIDG PMU Programme Manager, with the PIDG Governing Council providing a review/ 'no objection'. DevCo, while managed by the IFC, follows a similar decision making and governance procedure as the TAF. Governance and decision making for GPOBA lies outside the mandate of the PIDG as it is funded by other donors external to the PIDG Group as well.

Governing documentation

The overall governance structure for the PIDG is set out in the PIDG Constitution, which is signed by all the donor members. Drawing upon the requirements of the PIDG Constitution as appropriate, there are

Box 4.3: EAIF's decision making process

The figure below represents the typical process for approval of a loan commitment by the EAIF. Note that at each stage the decision making body can reject the proposal and the project therefore does not go ahead.

EAIF's decision making structure



In the case of 'sensitive' projects such as projects in conflict areas, the PIDG Governing Council is also required to provide a 'no objection' confirmation and any recommendation as appropriate.

typically three key documents which form the core governance documentation for the main privately incorporated facilities:

- The **Memorandum and Articles of Association or Constitution**, which *inter alia* sets out the aims and objectives of the company in question, how the company operates, what it can do, voting rights (including reserved rights) etc.
- The **Investment Policy and Operational Guidelines** of the facility which sets out what can and cannot be invested in, any country, sector or other limits.
The Investment Policy also outlines the poverty elimination criteria that PIDG projects need to satisfy. Before support is extended, a project needs to satisfy at least one of the following poverty elimination criteria:

- Underpin economic growth that assists either directly or indirectly in the elimination of poverty and the broader policies and context for poverty elimination and leading to social, environmental and or economic benefits for poor people; or
 - Benefit broad-based population groups including poor people and pro-actively addressing issues of equity and barriers to participation or access to poor people; or
 - Specifically promote and enhance the social, cultural and economic rights, interests and needs of poor people.
- The **Facility Management Services Agreement** which sets out the obligations of the manager and the fee structure, which typically has a high performance-related element.

For each of the private companies, EAIF, GuarantCo and InfraCo, there is also a Funders' Agreement between the donors, the vehicle and the PIDG Trust.^{31 32} In addition, due to its structure as a project finance vehicle, EAIF also has a number of core financial documents which grant the lenders various securities and step-in rights.

The aim of these documents is to protect the rights of all parties by ensuring that the operations of the facilities are substantively compliant with what was agreed when they were set up. They help ensure that the facilities and shareholders work as if they were in the private sector.

Reporting obligations

The management teams need to report to the facility Boards regularly in order to keep the largely non-executive Board members apprised of different issues. In turn, the Boards are required to report to the PIDG on at least a quarterly basis. The Boards thus play the important role of technical oversight for the facilities. In terms of financial oversight, all the investment vehicles have independent financial audits annually. Finally, as required under their company registrations, there is the appropriate documentation of the actions of the Board and the Committees including minutes of all meetings of New Business and Credit Committees.

4.3. Key benefits and challenges

We consider the key benefits and challenges in designing, implementing and operating the PIDG facilities below.

4.3.1. Key benefits

Advantages of the unique public-private partnership approach

There is a consensus amongst its stakeholders, that the PIDG offers a unique PPP model, leveraging the capacity and expertise of both the public and private sectors. This uniqueness is based on the fact that public funds from the donor agencies are managed and administered by the private sector in a commercial manner. This is an innovative PPP approach, wherein the capacity and expertise of both the public and private sector is leveraged to support improved infrastructure provision in the low-income developing countries. The benefits lie in allocating roles to those that are best placed to deliver results.

As such, the donors have committed public resources together with a policy commitment to support PSP in infrastructure in poor and risky environments. For example, donor equity in EAIF has managed to leverage additional financing from the private sector for investment in Sub-Saharan Africa. InfraCo, develops projects in areas where most traditional developers have retreated – this being possible because the donors have been willing to extend their capital in high risk projects which would not otherwise be taken up by other private developers in the market.³³

The private sector brings its entrepreneurial spirit, greater efficiency, innovation and discipline to the table, and enables the facilities to be run as commercial enterprises, supporting sustainable infrastructure development. For example, projects designed and developed by private sector expertise and skills, as is the case with InfraCo, are likely to be more attractive to the private sector for financing than those designed by civil servants. As a result, in the case of these PIDG facilities (i.e. those that are managed as private companies), the invested funds can be expected to be re-paid, thereby reducing the need for donor support in the future.

Thus, the unique PPP approach offers considerable benefits by harnessing the resources, skills and expertise of both the public and private sectors.

Efficiency in approval of funding

The PIDG operates with a highly decentralised structure, with the donor members primarily providing strategic guidance for the facility investment and operational policies, and the individual facilities taking forward their respective project portfolios.

This approach allows the management units to move forward efficiently and flexibly with their programmes, without donor interference in their day to day operations. As a result, the PIDG facilities are able to operate with greater speed as compared to some of the DFIs, leaving a market perception of efficiency and speediness in operations. Such an operational framework also promotes transparency.³⁴

There may be instances when the guidance of the Governing Council is required, usually on sensitive development or political issues. These would be circulated by the PMU for a ‘no-objection’ response within 10 working days, or a positive response, depending on the seriousness of the matter. In the case of the Affiliated Programmes, the Governing Council is simply kept advised of the progress of GPOBA, but is consulted on all DevCo project proposals using the same ‘no objection’ arrangement outlined above.

4.3.2. Key challenges

Realising the above, however, has not been without its difficulties. We present below some of the key challenges faced by the PIDG facilities.

Managing public private tensions

The challenge with the PIDG PPP approach is to manage the diverging incentives that drive the donors and the private sector managers – a ‘tension’ that is inherent in any PPP approach. For example, donor members are required to extend PIDG activities in the poorest countries and to achieve the largest development impact. However, private sector managers are driven by the viability of the investment opportunity and hence are likely to focus on more commercial projects so as to achieve a higher rate of return. Private sector managers require a higher level of compensation to match the greater efforts required to work in more difficult and complex environments.³⁵

Despite this, a measure of the success of the arrangements is that it has been possible to raise external private finance, first with EAIF, then with GuarantCo and InfraCo, because the facility managers can demonstrate that there is both a recognition of sanctity of contract and a flexibility / realisation on the donor side that the facilities ultimately need to be run along disciplined private sector lines.

Balancing facility sustainability with desire for smaller, more pro-poor projects

For the facilities to be successful, they are unlikely to focus only on high development projects. There needs to be a balance with more commercial projects to facilitate financial sustainability of the facilities. Balancing these two objectives presents a challenge at times for the facilities.

Avoiding micro-management

An important challenge in the PIDG approach is to actually make sure that the donors are hands-off in their approach. Previously the PIDG members had to put forward a no objection on each and every project – but this was subsequently revised for sensitive projects only, as it was not an efficient way of functioning. As discussed above, this current approach has fostered considerable efficiency in decision making.

Impatience for results / unreasonable expectations

One of the challenges faced in operating the facilities is the pressure for quick results from donor sponsors. In reality, it can take a number of years for a new facility to get up and running, and even after establishment, the process of building the project pipeline is gradual and requires careful consideration. A key challenge with working in the infrastructure sector in particular is the long lags before investments lead to actual development outcomes on the ground – while there may be some immediate impacts (for example, increase in employment to construct the infrastructure), most of the development impact is long term.

Managing non-PIDG shareholders' priorities

Given the new GuarantCo arrangements, in future years there may be further challenges regarding the fact that the equity owners of the PIDG facilities no longer all sit within the PIDG. This may add to some of the existing challenges of aligning different shareholder views. The potential difficulties involved, however, should be manageable to the extent that the PIDG maintains a majority ownership position in each facility.

5

Services provided by the PIDG facilities at the project level

In this section we consider the role of the PIDG facilities at the project level in terms of the support that they provide at different stages of the project cycle. These are typically; (i) support to project design, development and transaction / negotiation; and (ii) project financing.

5.1. Project preparation

Project preparation support can be provided through several routes:

- Governments wishing for such support can apply to either DevCo or InfraCo.
- PIDG facilities that have identified an opportunity can call on TAF funding to develop it further.
- EAF now has its own small project development fund.

Whilst they occupy a similar space, there is a key difference in the way that DevCo and InfraCo operate. The former is essentially an *Advisor* whose role is to support government sponsors of projects by providing financial and other expert advice. InfraCo on the other hand, acts as a *Principal* or sponsor of projects, developing opportunities at its own risk, and will enter into a joint development agreement with another party to share these risks and rewards.

The PIDG facilities themselves can all draw on TAF for technical assistance and capacity building, through the provision of advisors, arrangement of training, secondments or workshops, subject to the project being consistent with the overall objectives of TAF. Because of their core project development role, DevCo and InfraCo have been the greatest users of TAF,

however other facilities have also accessed the different TAF windows of support. TAF assistance extends from general technical assistance and capacity building support for projects by all PIDG facilities, grants to facilitate capital market development for use by GuarantCo (may not necessarily be project related) and grants for OBA assistance.

5.2. Project financing

As lenders and guarantors, the PIDG financing facilities are naturally more passive in terms of their activities than the more activist project preparation facilities. They will tend to be a part of a syndicate, providing or guaranteeing senior or subordinated loan tranches within a project financing structure.

5.3. Key benefits and challenges

5.3.1. Key benefits

Many of the observed benefits at the project level reflect the views of other market participants, who have accessed or worked with the PIDG on infrastructure projects.

Additionality of the PIDG facilities

Private commercial finance has been brought in to Sub-Saharan infrastructure markets, and at longer tenors than the private sector has ever offered before. Being able to participate up to

US\$36 million per transaction, after the IFC, EAIF is one of the largest long term lenders in Sub-Saharan Africa. Indeed, it is arguable that the introduction of EAIF was quite catalytic in terms of raising the profile of Sub-Saharan Africa with the DFIs/IFIs. For instance, whilst today the IFC is a big player in Africa, at the turn of the millennium this was not the case, at least for infrastructure. The momentum created by EAIF's establishment helped to draw attention to this gap in IFC's portfolio.

Other PIDG facilities have also played an additional role in infrastructure development of the low-income developing countries of their focus (i.e. DAC 1 and 2 countries). GuarantCo for example, offers an innovative product to foster local currency financing, with its focus being on the yet poorly served low income developing country markets. In addition, GuarantCo assistance in projects has also helped to facilitate local capital market development, although it is still too early to estimate the exact impact of its operations. InfraCo's additionality lies in developing projects where other private sector project developers would not usually venture.

Less bureaucracy

The PIDG facilities are typically seen as being far less bureaucratic than many other DFIs/IFIs. The general market perception of PIDG facilities is one of greater efficiency and smoothness of operations. Project sponsors, in particular, do not see a price advantage of raising debt from EAIF, but they know that they will be dealing with an efficient commercial lender. Other players in the market such as private project developers have commented on the efficiency of the TAF as well.

EAIF as a lender of last resort

On a number of occasions, EAIF has been prepared to lend to projects that others would not lend to, using a mixture of senior and subordinated debt to reflect such risks. As a result, EAIF has facilitated the crowding in of private finance. For example, EAIF funding of US\$22 million in senior debt and US\$8 million in subordinated debt, as a part of a US\$190 million syndicated facility for the development of Celtel international BV's Africa operations, was the final step required for the project to go ahead.

Knowledge transfer between facilities and countries of operation

The PIDG facilities offer considerable potential for knowledge transfer and sharing with the public and private sectors in the countries where they operate. For example, GuarantCo projects have facilitated the introduction of new instruments in domestic financial institutions, with considerable transfer of knowledge in structuring of projects, amongst other skills.

5.3.2. Challenges

EAIF's pricing structure

It has been found that EAIF is often uncompetitive as compared to other DFIs/IFIs. To some extent this was because of an initial high cost base, which was addressed to a degree by its refinancing. However, a number of DFIs price particularly keenly in Sub-Saharan markets, often with lower rates than in other parts of the world, suggesting a degree of cross-subsidy between other markets and Sub-Saharan Africa. To some extent, EAIF and potentially other private lenders, are now in some instances being "crowded out" of opportunities.

Crowding out

The case is different, however, when it comes to the PDF's, DevCo and InfraCo. By virtue of grant funding from the PIDG, there is a reasonably widespread market perception that these entities have access to “free resources” which gives them a competitive advantage when seeking to procure mandates from government.

This risk will always be there to a greater or lesser extent and needs to be carefully managed, for instance, through ensuring that the mandates sought are not readily contestable by self-standing developers and advisors or that the additionality provided by the PIDG facilities outweighs any anti-competitive costs. For instance, it is arguable that in certain circumstances, DevCo's links with the World Bank Group give it the necessary “traction” with governments to ensure that transactions are completed.

The facilities should also aim to crowd in private sector counterparts, through for instance, joint development agreements. In further mitigation, the PIDG focuses on the least attractive parts of the world and the facilities (excluding their management teams) have no private sector shareholders who benefit from such a privileged position as any profits are channelled back into developmental activities.

Project development by teams based in UK/ US

PIDG facilities function with small teams primarily based in the UK or the US.³⁶ This presents a challenge at the field level, particularly for a facility like InfraCo where proximity to opportunities determines flexibility and immediacy of responses. However, it should be noted that the PIDG teams are not at a comparative disadvantage as they have strong networks and associations with partners at the field.

The PIDG model of housing teams in London and Washington D.C. was based on a comparative assessment of the costs and benefits of locating in Sub-Saharan Africa. The trade-off lies with setting up new offices in different African countries, with possibly higher remuneration packages required to meet the costs of shifts in location of the management team.

6

Lessons learnt from the PIDG approach

This section presents a summary of some the lessons that different stakeholders feel have been learnt from the PIDG, linked to an assessment of the key benefits and challenges faced at the overall PIDG, facility and project levels, as discussed in Sections 3, 4 and 5 respectively.

A common view is that the overarching lesson that the PIDG experience offers is a **confirmation of the fact that the public and private sectors need to work together for infrastructure development and that this is achievable**. While the public sector will continue to play an important role, resource and capacity constraints imply the need to promote the private sector. This can lead to the efficient development of sustainable infrastructure and provide an opportunity for increased access and quality of services for the poor in low-income developing countries.

At the PIDG facility level, the PPP approach has achieved favourable outcomes by harnessing the strengths of both public and private sectors. The PIDG might thus be seen as ‘learning by doing’ by applying its advocated PPP principles to its own structure.

We have grouped a number of observations into the following sub-sections which we believe provide some useful lessons gained through PIDG’s experiences, based around:

- managing an alliance of multiple donors;
- establishing a successful working relationship with private sector partners;
- the limits of the approach, in terms of what has and what has not been possible; and
- other lessons.

6.1. Managing an alliance of multiple donors

Many of the benefits and challenges identified involve the successful management of a multi-donor entity. The lessons below set out some of the ways in which the PIDG has learnt how to make these work.

Recognising differences amongst donors and working flexibly

The PIDG involves a collaboration of donors of different sizes, capacities and experience in understanding and working on private infrastructure development. In addition, the PIDG donors are from different nations, thereby implying some divergences in their work practises and procedures. As a result, the PIDG has faced a few challenges in donor coordination, however, the lesson that has been learnt is to accept the differences and work as effectively as possible. For example, if a particular donor is unable to finance an initiative then the other donors will go ahead with it. A major lesson from the PIDG experience has been the need to play to the strengths of different donors and to work in a flexible manner where difficulties arise.

Single donor responsibility for designing and implementing initiatives

The PIDG experience has been that different donors have been responsible for the various stages in the development of the facilities. The major lesson to be drawn from this is that the design and implementation process for new initiatives runs more smoothly if it is handled by a single PIDG member. It is better that one PIDG member takes the lead as having more parties involved complicates the process, particularly in terms of obtaining various approvals in parallel. In

taking a proposal through one donor's approval processes, it is none the less important to ensure that there is no material problem that might get in the way of other PIDG members joining at a later date.

The PIDG has not required a “grand plan”

The PIDG approach has been to develop facilities on the basis of need: that is, as a market constraint becomes apparent, the PIDG has explored the appropriate action it may take in order to address it. The PIDG facilities have therefore tended to be developed on a piece meal basis, rather than being part of a comprehensive programme from the start (although many of the market failures have been known for many years). Different PIDG donors have contributed and sponsored different ideas.

In addition, PIDG initiatives have been developed only after an in-depth examination of the existing facilities in the market to tackle the particular constraint/(s). The PIDG has explored the option of working with existing initiatives so as to prevent replication or over crowding in the “donor” market. As a result, the PIDG facilities have played a highly additional role in the market, and continue to do so. In doing so, the PIDG has co-ordinated with an ever increasing circle of donors, some of which have elected to join PIDG, others have become partners outside the formal PIDG arrangements.

This approach also offers an important lesson in terms of the additionality and impact that initiatives can achieve when they are demand driven.

Development of complementary facilities has promoted their growth

Development of complementary facilities under the PIDG umbrella has enabled the harnessing of the strengths and reputation of one facility

for the benefits of other facilities. A case in point is the development of GuarantCo, which is also managed by the same management team as EAIF. This has enabled the faster evolution of GuarantCo on the back of the good reputation of the EAIF facility managers in the market.

6.2. Establishing a successful working relationship with private sector partners

The other key dynamic within the PIDG arrangements has been the public-private sector interface.

The facility Boards play an important role in balancing the requirements of the donor members and the facility managers

A key lesson from the PIDG approach is the important role played by the Board members of the facilities in balancing the objectives and requirements of the donor members with those of the private sector fund managers. The donor members are keen to promote highly developmental and poverty focused projects, whereas the private fund managers, while being cognizant of this objective of the donors, are typically more concerned with the commercial viability of a given project. As a result, at times the two parties may conflict on the type and nature of project to be supported by the facilities. In this context, the Board members play a crucial role by reviewing and recommending proposals made by the facility managers, thereby ensuring that only projects which fully meet the investment criteria, (including the developmental criteria) are taken forward.

In addition, the donor members often have insufficient knowledge of infrastructure project development and financing, especially for private and PPP projects, to always understand why the facility managers are advocating a particular approach. Again, the Board members have an

important role to play in sharing knowledge with and guiding the donor members through the financing and other issues.

Key to playing an effective role is the ability to attract the right mix of experience and calibre of individual to the respective Boards. The experience of PIDG has been that it has been able to attract well qualified and experienced individuals to the Boards, who are committed to the initiative. What has made a difference is the public service element in the PIDG initiatives and projects which, to varying degrees, has rubbed off on both Boards and indeed even the facility management teams.

On the whole, this model would appear to be relatively unique within the sphere of international infrastructure development, with the Boards offering a huge innovation without which the investment commitment process could have been much more complicated and protracted.

Important to the PIDG approach is ensuring that management teams face the correct incentives

While the privately managed PIDG facilities operate in a fully commercial manner, the facility managers need to keep in mind the overarching objectives of their sponsors as laid out in the investment policy guidelines. Whilst these stress developmental objectives, they are combined with contractual arrangements which provide reinforcing commercial incentives. As a result the management teams can recognise and understand how to develop/finance projects which meet the development objectives of the donors as well as the profitability and sustainability requirements of the facilities.

In addition, the task of the facility managers is not an easy one – by virtue of working in some of the most difficult and riskiest

environments – and hence it is important that the facility managers have the right mix of skills and incentives to work in these environments.

Recognising that the skills and expertise of the private sector come at a cost

If the facilities are successful, the compensation packages contain performance-based elements in the form of bonus / success fees (incentive payments), which makes their overall package potentially highly remunerative. These can often seem extremely high to public sector employees, but studies commissioned by the PIDG have shown that the remuneration packages offered are not out of line in terms of the alternatives open to the individuals concerned. However, much of the success of the PIDG model has been down to the quality of the private sector fund management staff involved in driving forward the facilities. This emphasises the need to provide remuneration packages that are adequate to attract staff of the right quality. It is thus important for donor organisations looking to work with the private sector to recognise the relatively high cost of the remuneration packages that will need to be offered if staff with the necessary breadth of experience and expertise are to be attracted to work on high risk initiatives such as those developed by the PIDG.

The need for patience

While most of the operations of the PIDG facilities and affiliated programmes are carried out with minimal donor intervention, the donor members, by virtue of being ‘shareholders’ in the private sector managed facilities, have an active say on the overall direction and high level strategies and targets of each facility. However, from time to time the Boards and facility managers have sensed impatience from the PIDG that progress has

not been quicker and some of the projects have not been more evidently developmental.

The donor position is understandable, given that for many years private sector participation was presented as something of a panacea for the challenges of infrastructure provision. However, as the facilities have developed and the number of projects has grown (with significant sums of private sector finance being attracted to projects in the poorer developing countries, which in itself has been seen as having a significant developmental impact) the donor understanding of the constraints faced by the fund managers, together with a realisation of what has actually been achieved on the ground, has increased. As a result, there has been a moving together from both sides, with an increased understanding by the donors of the problems faced by the fund managers and the fund managers putting additional effort into seeking to maximise the developmental impact as they take projects forward.

Close coordination between donors and the private sector managers / directors is essential to ensure success and efficiency

In a multiple partner organisation such as the PIDG wherein there are several actors with different roles, close coordination and cooperation is essential to ensure smooth and efficient operations. There needs to be effective channels of communication between the partners so as to share any issues and concerns and also for knowledge sharing purposes.

6.3. The limits of the approach

In addition to the above mentioned successes, a number of limitations of the PIDG approach have been identified as the initiative has grown and developed further.

Alleviating market failure for lending to infrastructure

During the feasibility study for EAIF, one of the key issues to be addressed was whether banks were unprepared to lend to most infrastructure sectors in Sub-Saharan infrastructure markets because of an excessive aversion to assessed risks (arguably a form of market failure), or whether the banks were correct to be so wary. Indeed, initially there was a great reluctance to lend to EAIF by some key lenders because of the perceived risk. Interestingly, not only did the senior lenders ultimately commit US\$120m, but on refinancing this exposure was increased by a further US\$60m (50%) and at a much lower interest rate. This might suggest that there was a degree of “market failure” within the Sub-Saharan infrastructure credit market, which EAIF’s financial structure has helped to alleviate.

Type of project financed

Against this, it remains the fact that there are a relatively limited number of projects which are considered bankable. These typically have either direct or indirect access to a foreign exchange earnings stream, in the sense that they are either a foreign exchange earner such as a mine or else a supplier of services to a foreign exchange earner (such as a transmission line). It is hoped that, over time, GuarantCo (and possibly the CLF) will be able to address this constraint – which will be a major breakthrough – indeed, something of a “Holy Grail” of development financing.

Another distinction in the type of project financed through PIDG activities is the focus on infrastructure sectors such as telecoms and power. While PIDG supports many other infrastructure sectors as well, experience has shown that more than half of the projects financed by PIDG have been in the telecoms and power sectors. This follows from the relative ease of recovering costs from users from these sectors as compared to other sectors such as water and sanitation.

Highly developmental projects need to address the issue of affordability

The experience with PIDG has been that the donors have emphasised the development impact of projects to a strong degree with, for example, additional funding being contingent on achieving a particular targeted development impact. While the importance of this cannot be contested, a need has been felt to attain a balance with other objectives such as sustainability of the fund (thereby requiring a mix of both ‘more profitable- higher returns’ projects along with ‘higher developmental- lower returns’ projects).

Affordability of infrastructure services is a key issue in low-income developing countries, where the majority of the population do not have the resources to pay for the use of the services. This inhibits full cost recovery tariffs, and therefore the sustainability of the infrastructure service. As a result, the issue of affordability needs to be addressed and approaches such as output-based subsidies assume crucial significance.

The PIDG has a close partnership with the GPOBA. However, in the face of many claims for the resources of the facility, PIDG projects have not been able to draw on the resources of GPOBA as much as desired. As a result, as discussed above, the PIDG has now developed an OBA window within the TAF. This, however, is something of a drop in the ocean when compared to the scale of such resources required to address the affordability gap.

Need to support capacity building of the government and its agencies

The PIDG experience has highlighted the need to build and support capacity amongst the government departments to

understand PPP and private project structures and to work more efficiently with the private sector. This is a gradual learning process and initiatives such as TAF and DevCo have had a positive impact on developing capacity.

6.4. Other lessons

A number of other lessons have been observed, which do not fit neatly in to the above.

Indicators to measure progress of infrastructure projects need to be suitably designed

As discussed above, infrastructure development entails results in the medium to long term with minimal immediate impacts. As a result, indicators to measure progress need to be designed accordingly – for example, indicators that measure intermediate progress as against the final results. It needs to be clearly recognised that measures for the final results can only be estimates, which need to be revised as the project progresses.

Lack of project developers in the Sub-Saharan African and other developing country markets

The experience of InfraCo has shown that there is considerable demand for other project developers in the market to develop bankable infrastructure projects. Poor bankability implies that projects may often fail, thereby resulting in a low conversion rate between commitments and disbursements of lenders. Private sector developers are constrained by a lack of resources to support their project development activities. As set out above, however, there may still be instances where especially attractive or enclave projects attract several developers.

Important to build institutional memory within an organisation as large as the PIDG

The PIDG is an extensive initiative involving several actors and stakeholders. Developing a continuous practice of developing institutional memory for its donors, managers, directors and other stakeholders is crucial to ensure a smooth flow of information as personnel linked with the PIDG move on and others join in their place.

6.5. Endnote

One of the key aims of this document has been to highlight the alternative approach followed by the PIDG, in order to emphasise not only the benefits of some of its structures and systems, but also to bring out the challenges and lessons to be learnt from its experience. In this regard, it is hoped that this document will serve not only to provide interesting information, but also to serve as a useful reference guide for other donors and organisations seeking to engage with the private sector in developing infrastructure in poor countries.

References

1. The PPIAF is an honorary member of the PIDG.
2. <http://www.unmillenniumproject.org/index.htm>
3. PIDG's sister facility, the PPIAF has largely focused on addressing issues relating to poor enabling environments for infrastructure development.
4. Facilities marked with an asterisk in the figure refer to facilities in development.
5. As explained in Section 3 below, the PIDG PDFs and PFFs are either direct PIDG facilities (i.e. funded through the PIDG Trust) or Affiliated Programmes that are funded through other Trust Funds located at the World Bank.
6. Note that certain aspects such as construction and post project implementation support have been excluded in this discussion to simplify the analysis.
7. The European Commission might also be included as a multilateral grant provider.
8. Whether development banks extend credits and soft loans to governments or directly to projects they require an indemnity from government. As such they take on sovereign rather than project risks. Today sub-sovereign lending approaches typically involve the use of structures and approaches associated with mitigating risks in private sector projects as there has been a desire to avoid having to have a government indemnification.
9. From 2007, EAI put aside a proportion of its retained earnings for a 'Project Development Facility' (PDF) as an additional source of grant money to augment technical assistance activities, available to all projects supported by PIDG facilities subject to certain criteria. Grants are convertible to equity in projects where the assistance provided produces a feasible project.
10. TAF is managed by the private sector, but its structure is different from the other private facilities. This is discussed further in Section 4 below.
11. A further problem with this arises in that many of the initial facilities were designed to promote backbone infrastructure, power generators, transmission lines, airports, etc which are not particularly amenable to evaluation approaches which stress direct pro-poor benefits. This does not make them any less important to the development of poorer economies, investment and job creation.
12. Note that these figures include commitments by DFIs.
13. The key monitoring indicators used by the PIDG Group include: the increase in private sector investment for infrastructure; improved access to infrastructure services (both in terms of additional connections and improvement in existing services); fiscal impact in terms of avoided subsidies by the government, revenue through up-front fees and on-going tax payments; the overall impact on employment; and alignment of investments with national development plans.
14. GDP per capita 2006 (constant 2000 US\$), WDI
15. The PPIAF is not a project development facility per se, but can support pilot transactions, although it does this rarely.
16. Notes to data: All data excludes regional projects, i.e. figures are country specific; exchange rates calculated as an annual average for the year the data was taken www.x-rates.com; IFC infrastructure department debt and equity financing is for 2007; technical assistance is the sum of estimated total funding IFC Annual Report www.ifc.org; World Bank new commitments approved for 2007, IBRD, Annual Report 2007 (lending data) www.worldbank.org; MIGA infrastructure projects since 2005 – amount of guarantee coverage issued at original contract signing for active and proposed projects www.miga.org; EBRD finance in 2007 www.ebrd.com; EIB finance contracts signed: excludes EU and EFTA countries www.eib.org; DEG country portfolios as at 31 December 2005 www.deginvest.de; FMO projects by region (all sectors) contracted April-September 2007; www.fmo.nl/en; PPIAF Annual Report, fiscal year 2006 www.ppiaf.org; AfDB Loan and Grant approvals 2006 – Compendium of Statistics on Bank Group Operations 2007; <http://www.afdb.org>; ADB loan approvals by country 2006 – Annual Report 2006; http://www.adb.org/Documents/Reports/Annual_Report/2006/default.asp; ADB funds include sovereign and non-sovereign guaranteed loans; OECD, ODA net disbursements – 'Stat extracts'; <http://stats.oecd.org>.
17. The OECD Country Risk Classification measures the country credit risk, i.e. the likelihood that a country will service its external debt. The classification is based on: (1) the Country Risk Assessment Model (CRAM), which produces a quantitative assessment of country credit risk, based on three groups of risk indicators (the payment experience of the Participants, the financial situation and the economic situation); and (2) the qualitative assessment of the Model results by Country Risk Experts, considered country-by-country to integrate political risk and/or other risk factors not taken (fully) into account by the Model.
18. The guarantee provided to an 'unrated' country was US\$427m for investments in a Container Terminal in Djibouti, which can be regarded as high risk.
19. The founding members of the PIDG are DFID, the Swiss State Secretariat for Economic Affairs (SECO), the Netherlands Ministry of Foreign Affairs (DGIS), the Swedish International Development Cooperation Agency (Sida) and the World Bank Group. Since 2006, PIDG membership has expanded to include the Austrian Development Agency (ADA) and Irish Aid. PPIAF is an honorary member. The PIDG donor base may expand further to include other like-minded donors, based on the need for additional resources to support current or newly identified constraints to private participation in infrastructure in low-income developing countries.
20. The mission statement is as of 2008.
21. Note that GPOBA in particular is slightly different from the remaining facilities as it is funded by donors apart from the PIDG group of donors and therefore has independent governance arrangements as well.
22. As per the PIDG Constitution, a donor organisation needs to submit a letter to the Governing Council to be accepted as a member of the PIDG. The Governing Council then reviews the application and decides on its membership. PIDG membership requires a minimum overall commitment of US\$10 million over a four year period in one or more of the PIDG facilities and for a contribution to the general administration costs of the PIDG. As a result of the project approval processes within DevCo and GPOBA, an investment in these two facilities is not considered eligible for these purposes.
23. Note that the PIDG members do not own the Trust or the PIDG facilities and investment vehicles. Formal legal ownership of the PIDG facilities is vested in the Trust (ownership of the Affiliated Programmes lies with the Trusts at the World Bank). However, the PIDG members are accountable to their parliaments for the oversight and correct use of the funds that they allocate to the Trust (as well as other associated PIDG investments which do not go through the PIDG Trust, e.g. for DevCo).
24. The choice of Mauritius as the location was based on its suitable 'light' mechanism in terms of Trust requirements and favourable tax-related issues, as well as acceptability by the members from a transparency perspective. The Trust was also placed under Mauritian law because under UK law it is not possible to have a purpose trust which is not charitable. Whilst the purpose of the PIDG Trust is developmental and contributes to the achievement of the Millennium Development Goals, it is not charitable from a UK law perspective.

25. Under Mauritian law, the Trust is required to have an Enforcer. The Enforcer's duty is to enforce the provisions of the Declaration of Trust in consultation with the PIDG and on the advice of its legal advisers. The Enforcer will only act if any or all of the Trustees are not acting in accordance with the Declaration of Trust or their legal obligations as trustees, i.e. it acts only as a "last resort". At present, the Enforcer is DFID and the PIDG may appoint another or additional Enforcers as appropriate. The Trust also has a Protector, which, whilst not a legal requirement under Mauritian law, ensures that the Trust acts in accordance with the objectives of the PIDG. At present, the Protector is CA Legal, the legal arm of the Crown Agents.
26. The contract for the current PMU expires in early 2009 and Sida is in charge of the procurement of a new PMU.
27. EAIF involved a joint bid for management services and financing.
28. GuarantCo initially had a very small management team seconded in to it. The GuarantCo Board subsequently procured the long term management team.
29. This figure reflects GPOBA assistance that has been provided in association with another PIDG facility. GPOBA also supports other projects independent of the PIDG.
30. The funds invested are not so much FMO's own capital, but rather DGIS funds which FMO invests on DGIS's behalf.
31. The Funders' Agreement for InfraCo is currently in draft form.
32. For EAIF, the Funders' Agreement is only between the donors.
33. Note that despite this, InfraCo operates on a completely commercial basis.
34. All PIDG facilities have adopted a code of practice endorsed by Transparency International.
35. Related to this is the issue of balancing banks' priorities with those of the donors in the case of the EAIF. Banks are concerned with the creditworthiness of projects, any potential donor interference, etc., especially so since they do not have commercial control of the fund through for example a seat on the Credit Committee and Board.
36. DevCo has an office in Johannesburg and also benefits from the IFC offices across Sub Saharan Africa.

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