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## The Financing of Public - Private Partnership (Ppp) Projects in Romania - An Evaluation of the Awareness and Know-How among Romanian Organizations

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*In many countries, anti-crisis public measures focus on higher public investment or investment in public objectives, like investment in infrastructure projects, as an important mean to maintain economic activity during the crisis and support a rapid return to sustained economic growth. An instrument to realize these investments is the Public-Private Partnership (hereinafter PPP).*

*Nevertheless, PPP's are vulnerable to the economic impact of the crisis. Although the final consequences and duration of the crisis are not yet known, the effects on PPP's can already be identified and estimated. The crisis has made the conditions for this instrument more difficult. Despite some signs of recovery, the volumes and values of the PPP projects currently closing is still significantly below the level reached before the crisis.*

*The topic of PPP financing has never been more important than under the current crisis. Alternative innovative solutions are being sought, new markets need to be opened in order to enable the further development of PPP, the stakeholder organizations have to increase their level of understanding regarding the new environment for PPP.*

**Keywords:** *public-private partnership, management, project finance, economic crisis, stakeholder*

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*JEL Classification: D53, G01, G18, H54, H57, L32, R42*

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## Introduction

After the 2007, Lisbon Strategy has been challenged by the recent economic and financial crisis, the Europe 2020 Strategy for smart, sustainable and inclusive growth sets out the vision of the European Union (EU) economy over the next decade. Given the huge infrastructure investment volumes that require the implementation of this strategy and the pressures facing government budgets, attracting private capital to finance the infrastructure investment has become crucial.

The quality and density of infrastructure varies considerably across the EU with significant investment needs in new areas and for maintenance and upgrades of existing infrastructure in others.

However, the issue of PPP projects financing cannot ignore the international economic and financial context. The actual financial crisis had a negative impact over PPP development at the level of the European Union, particularly in the Central and Eastern European states [1] presents us the fact that the liquidity shortage on the market, the loss of capital markets as source for project financing, the increase of the interest rates, all led to the drop of the availability of the financing institution for involvement in PPP projects and even to their withdrawal in some cases, out of already started PPP projects.

In the last few years, EU has been promoting the Public-Private Partnership (PPP) as a valid instrument of accomplishing the Europe 2020 goals. There is no doubt that Romania belongs to those Member States that have a shortage regarding the quality level of the existing infrastructure and where its modernization is a mandatory need and a top priority. Romania has even a stronger economic reason for promoting infrastructure investments, as it is generally acknowledged that such investments have significant indirect benefits and even a positive impact on long-term growth, although this effect might vary across different sectors.

Despite their unsuccessful history in this area, the PPP infrastructure projects have a great potential on the Romanian market, as the need for investment in this field, caused by the poor quality of the

infrastructure is very high. Considering the limited public budget resources and the context of the international economic and financial crisis, the financing of large infrastructure projects becomes more and more difficult, so that the PPP mechanism represents a real opportunity but, at the same time, a challenge for the involved parties. Under these circumstances, the understanding and clarifying of the PPP concept, both in the public sector and among the organizations from the private sector, becomes a priority success factor for the implementation of this solution on the market.

In Romania, the interest for PPP must be encouraged, both in the public and in the private sector. While at the level of the public sector, the knowledge in this field would increase the administrative capacity, in the private sector, there are positive effects regarding the competitiveness increase of the Romanian companies from different fields of activity, relevant for implementation under PPP. Acquiring this knowledge at the management level of the different organizations is mandatory for the private sector participation in these projects, as well as securing the position and involvement of local companies within PPP projects, either as partner in a consortium of Romanian companies or in consortia of international companies with experience in this area.

## **Literature review**

One of the main characteristics of a PPP project versus the conventional provision of infrastructure is the bundling of investment and service provision in a single long-term contract. For the duration of the contract (typically over 20-25 years) the concessionaire manages and controls the assets, in exchange for user fees and government transfers, which compensate for investment and related operating costs. At the end of the concession, the asset goes back into the ownership of the public authority.

Due to its relatively young history, the economics of PPPs is still imperfectly understood. Many claim that PPPs relieve strained budgets and release public funds, while others argue that PPPs are appealing because of the delegation of finance, investment and management to private firms, making it more efficient. Despite all these reasonable arguments, in many cases contracts have been renegotiated in favor of the concessionaire, and

sometimes firms have been affected by regulatory takings. The profitability of PPP projects is subject to large exogenous demand uncertainty, which is often not considered properly when designing the contracts.

[2] Considers that the main characteristic of PPPs is the bundling of investment costs with life-cycle operation expenditure. A PPP is superior to conventional provision when the benefits of cost cutting investments during the building phase are not undone by the cost to users of lower service quality.

Nevertheless, the topic of risk sharing between the government and the concessionaire has always been a concern among practitioners and policy makers, with the standard prescription that each risk should be allocated to the party best able to manage it. [3] Study this problem in a moral hazard model where effort during investment affects both the quality of the infrastructure and its operating cost. [4] Study the implications of the optimal allocation of demand risk, when subsidy finance is less efficient than user-fee finance, showing that the variable, state-contingent concession lengths are a key component of the optimal risk-sharing contract.

[3] Provide a theoretical framework to identify circumstances in which the main characteristics of PPP arrangements are suitable to provide incentives for the private providers in the transport sector, characterizing transport PPP's by four main features: tasks bundling, high-risk transfer, long-term contracting and private finance.

Having all this in mind, we aimed to show in several articles about PPP in Romania, a very popular topic in the public debate, but very unpopular when implementing into practice, that the solution in order to increase the implementation capacity is adopting a managerial approach focused on operational aspects of a PPP. We will present within this paper the results of a study on the management capacity of Romanian organizations regarding the implementation of PPP and we will focus on the issues regarding the financing of PPP projects.

## **Research methodology**

In order to evaluate the PPP management capacity of Romanian organizations in general and the level of awareness and Know-How regarding the financing of PPP projects in particular, we conducted a

quantitative research addressing 1.716 organizations in Romania, from different fields of activity and different sizes. The sample selection criteria is summarized below:

- the relevant field of activity for PPP implementation, like: banking, construction, technical consultancy, financial and management consultancy, legal consultancy, public administration (agencies, administrations, national companies etc), various associations, embassies and trade missions, chambers of commerce and industry, education and research as well as various operators from areas considered relevant for PPP implementation: transport, energy, environment, water and drainage, electric services etc.
- the size of the private sector organizations in terms of turnover – we selected companies, which, in their fields of activity, have reached a significant development, proven by the turnover of the previous years. On the other hand, the research sample has covered small, medium-sized and large enterprises, in order to ensure a higher statistical significance.

The interest for PPP belongs not only to the major stakeholders directly involved in the acquisition of projects (e.g. large international construction companies, operators), but also to companies from various fields of activity, that are potential subcontractors for specific activities of these PPP projects. Therefore, regardless of the activity, all the companies sampled have made a turnover of over 1 million euro, regardless of their activity. To ensure the statistical relevance for the construction sector, only construction companies with a turnover of more than 5 million euro have been selected.

- the position of the interviewed person within the company – we have selected only top managers, with direct influence in strategic decisions of the organizations they represent.

As mentioned above, 1.716 top managers from different organizations have received the questionnaire by e-mail and 555 of them returned valid answers. We consider the response rate of approximately 32.3% as being good, considering that the position of the respondents (e.g. general managers, group presidents or senior partners).

The design of the questionnaire used for the research was based on the results of two previous studies:

- a qualitative and explorative one, based on interviews with several experts from different field of PPP implementation (finance, construction, technical consulting, law, public administration)
- a quantitative secondary research, based on a PPP database coming from the Ministry of Finance in Romania.

The questionnaire consists of 23 questions structured in 6 sections, plus a section inquiring formal data about the participating organizations. The sections are:

- Defining elements for PPP
- General issues of PPP implementation in Romania
- Legal framework on PPP in Romania
- Financing PPP projects in Romania
- Risk allocation within PPP projects in Romania
- Information, involvement and preparedness level for PPP in Romania
- Data about the responding organizations

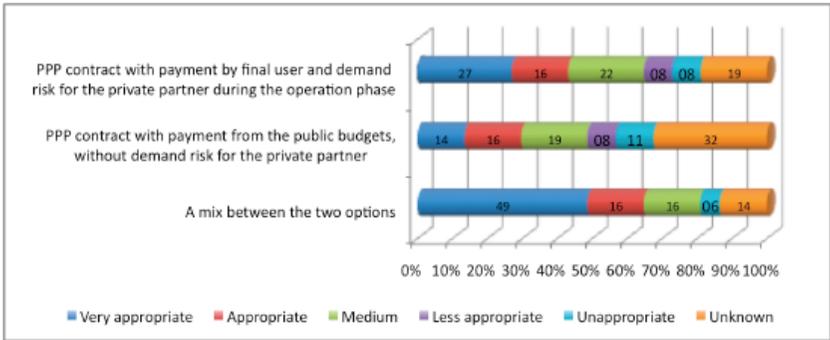
The questionnaire is available in electronic form under:

[http://www.dcc-management.ro/chestionar/index\\_en.php](http://www.dcc-management.ro/chestionar/index_en.php)

This article will focus on the 4th section of this research - "Financing PPP projects in Romania" - and present the most relevant results obtained.

## Research results

The topic of PPP project financing in Romania, represents, from an operational point of view, a key element regarding the capacity or incapacity to implement PPP projects. Due to the fact that the financing for PPP comes from the private sector, the first aspect that must be considered is how the investor can have a return on the PPP investment, including here, of course, a satisfying profit margin as well. From this point of view, the studied methods are the three classical ones, meaning PPP contract with payment by end users, PPP contract with payment from public budget and a mix between the two methods.



**Figure 1:** Achieving the return on private investment in a PPP project  
 (Source: survey collected data)

The best option resulted out is “a mix between the two options”. The next largest share, 27% of the respondents consider very appropriate the model of direct payment by users, while only 14% of respondents considered the model with payment by government budgets to be very appropriate. Basically, we can conclude that over 60% of the respondents consider the mixed model as "very appropriate" or "appropriate".

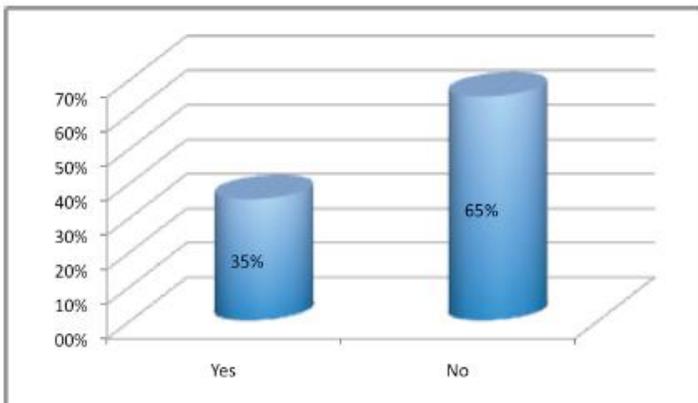
Regarding the return on investment possibilities, we noted a weighted attitude of the respondents, which basically consider that the involvement of public authorities in taking over a part of the demand risk volume is important, but definitely not entirely. The view of the experts is that a 100% private recovery of the investment is unlikely, and maybe even impossible under current conditions of the Romanian economy, especially within the actual economic crisis.

As long as achieving a satisfying return on investment represents a fundamental aspect both for initializing and operating a PPP project, with major impact on the contract negotiation phase between the private partner and the contracting authority, a more detailed analysis on this particular theme has been conducted. Referring to the return on investment, the most difficult are projects of large scale, with values of over 50 million euro. Thus, we have correlated the answers that considered the scale of over 50 million euro as being appropriate for PPP projects in Romania, with answers that considered as “appropriate” and “very appropriate” one of the options of

investment recovery proposed in the questionnaire, meaning direct payment by users, direct payment from public budget, or a mix between the two.

The conclusion shows that 72% of the respondents mentioned earlier, consider that the optimal way to achieve their return on investment is the mixed model, with risk sharing between the private and public partner; 52% considered that the best way is payment by final users and total takeover of the risk, by the private partner, while 16% of the respondents considered the possibility of re-payment from the state's budget and no risk to the private partner for being appropriate in order to achieve the return on investment. The answers show a positive and pro-active attitude of the respondents regarding take-over of the demand risk, together with a relative indecision regarding the total or partial risk take-over by the private partner.

A very important step in the launch phase of a PPP project and long before the return on the investment is to obtain the private financing for such a project.

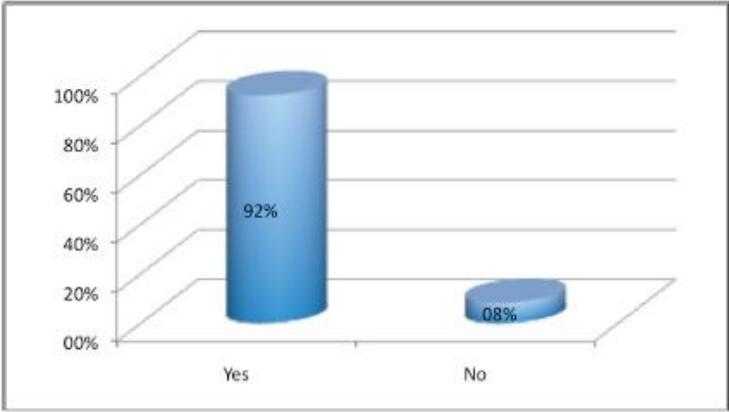


**Figure 2:** Information level regarding the conditions to obtain a private financing for a PPP project  
(Source: survey collected data)

The research analyzed the level of know-how regarding the conditions to obtain private financing for a PPP project. The answers demonstrate the lack of know-how on this matter, with 65% of the respondents replying negatively to this question. A significant increase of

the know-how regarding the conditions to obtain private funding, among the organizations interested to participate in PPP projects, is essential in order to increase the capacity to implement PPP projects in Romania.

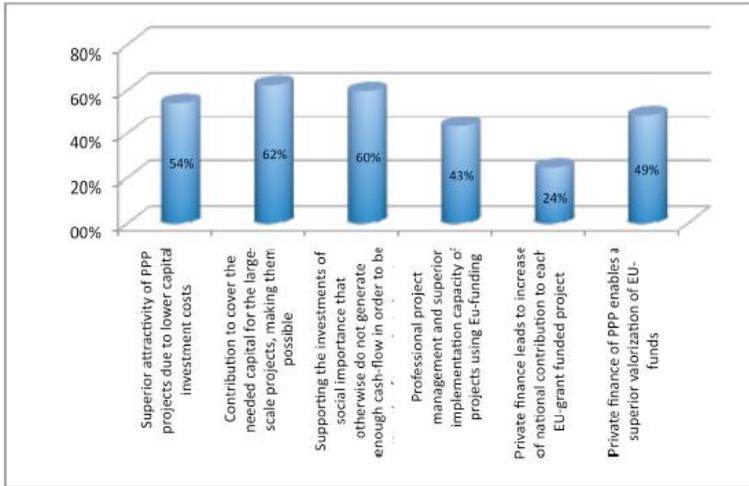
With regard to the topic of funding possibilities for PPP projects, the research analysis a new thesis emphasized more and more often during the past years at the level of European Commission and international financial institutions. It refers to the compatibility of EU grants with PPP projects, aiming to re-launch this sector at EU level.



**Figure 3:** The opportunity of making PPP projects compatible with EU grants in Romania  
(Source: survey collected data)

From the 555 respondents, 92% consider the co-blending of EU grants with PPP as good opportunity. This thesis, of making EU grants and PPP projects compatible, is without any doubt, extremely attractive for all stakeholders involved in a PPP project, because it pulls out the advantages and defining elements of PPP, like superior economic return, superior economic security, as well as superior security for the financial sector. Considering the interest and openness to this option, the possibility of operating this compatibility and also the identification of possible constraints must be carefully examined.

A first step in this direction is understanding the clear advantages of co-blending EU grants with PPP projects in Romania.



**Figure 4:** The main advantages of EU-grants implementation in PPP projects  
(Source: survey collected data)

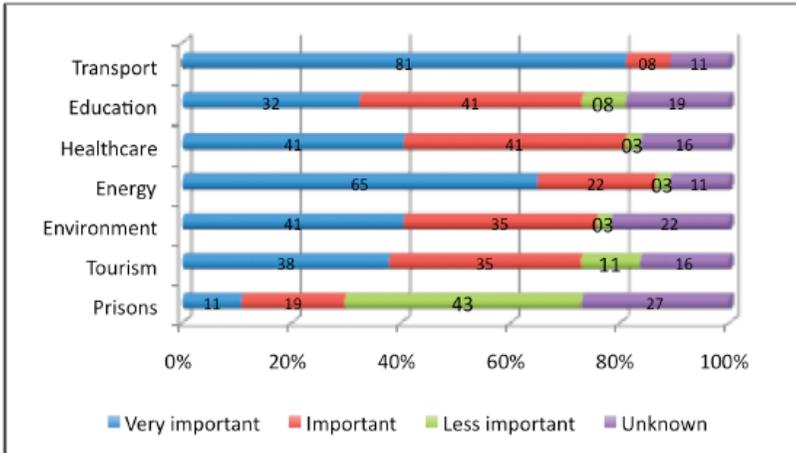
The research analyzed the respondents' perception over several potential advantages, which are identified by EPEC (European PPP Expertise Center) in 2010 [5]. Hence, the perception of the respondents is summarized below:

- superior attractiveness for large scale projects because of lower capital investment costs (54% of total response)
- contribution to the coverage of the needed capital for larger scale projects, making them possible (62% of total response)
- supporting investment of social importance, which otherwise would not generate (sufficient) income, in order to be attractive to private investors (60% of total response)
- professional project management and superior implementation capacity of projects using EU grants (43% of total response)
- at the same time, private funding of PPP projects leads to the overall national contribution level for each project co-financed from EU grants (24% of total response)

- private financing of PPP can better valorize the EU funds (49% of the total response)

We notice the respondents' preference for those advantages of EU funds co-blending with PPP, that regard the improvement of finance conditions for larger scale projects and for projects of social importance.

In order to conduct the further analysis of the opportunity given by EU-funds compatibility with PPP, we sought to identify the most adequate sectors for the implementation of this co blended funding.



**Figure 5:** The appropriate sectors for EU-grants co-blending with PPP in Romania  
(Source: survey collected data)

The main field for realizing this compatibility is, from the respondents' point of view, the transportation sector, considered "very important" by 81%. Next is the energy sector, considered "very important" by 65% of the respondents, health and environment with 41% each, and also tourism with 38% of the total response. The secondary fields in terms of this compatibility are education and justice (prisons).

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## CONCLUSIONS AND RECOMMENDATIONS

Regarding the possibilities for return on investment, the attitude of PPP stakeholders is weighted. The involvement of the public authorities sharing the risk of demand volume is mandatory, while most of the respondents understand that a return on investment 100% privately is rather impossible, especially under the conditions of economic crisis.

Since the Know-How of PPP stakeholders regarding the possibilities to obtain the private financing for these projects is rather absent, a significant increase in the level of awareness on this matter is becoming an essential factor for the increase of the PPP implementation capacity in Romania.

The thesis of co-blending EU funds with PPP is extremely attractive for all potential PPP stakeholders. However, a detailed analysis of possibilities for setting this compatibility into practice as well as of its possible constraints is needed. The main preference for the advantages offered by the compatibility of European grants and PPP projects regards the improvement of the financial solutions for larger scale PPP projects and for projects of social importance. The sectors where this compatibility would be optimal (transportation, energy, health and environment) are in alignment with the options selected as the most needed fields of PPP implementation in Romania.

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