Governments and Business Together: Creating Public-Private Partnerships

Vinod K. Aggarwal- Chief Economist, Frost & Sullivan

2014

Globalization is driving governments to be creative in attracting investments. With the inward-looking import substitution policies long gone, the game has shifted from regulating MNCs to finding creative ways to attract them. As countries seek to increase exports, improve their technological capacity, and provide high quality goods and services to a more discerning population in light of open markets, Public-Private Partnerships (PPPs) look increasingly attractive. Indeed, with burgeoning debt problems and big government deficits in the wake of the 2008 financial crisis, PPPs have emerged as the next big thing.

What's so special about PPPs? Why not let in MNCs to invest and provide goods and services? Some countries that opened up their markets in the 1970s and 1980s found that MNCs primarily displaced local producers, soon dominating their markets. Even when MNCs came in with joint ventures with local businesses, their dominant financial and technological position allowed them to call the shots. The idea that MNCs would share their intellectual property and enable countries to industrially upgrade their economies turned out to be a vain hope. MNCs generally refused to share their latest innovations, and transferred older technologies that did not allow local firms to gain competitive edge.

PPPs are seen to be a different animal, which are significantly more attractive to governments looking for foreign direct investment or those seeking to work with local businesses in domestic PPPs. (Our focus here is primarily on PPPs with MNCs). They allow governments to transfer huge public financial burdens and risk to private entities, while forging relationships between government and business.

In early August of 2014, at the U.S. – Africa business forum, strategies to create successful PPPs were a key focus of debate in shaping Africa's future and taking advantage of its opportunities for economic progress.[1] For many developing countries, shortfalls in public financing of infrastructure and public services are a grim reality. Without infrastructure, any

---

[1] http://iipdigital.usembassy.gov/st/english/texttrans/2014/08/20140805304847.html?CP.rss=true#axzz3AhJDRQG9

industrial policy initiative or effort to boost business is likely to be a failure. As an EIU-ADB report notes, “Power shortages impinge upon the development of manufacturing and urban clusters; inadequate roads, seaports and airports hamper the movement of goods and labor; and poor water and sanitation systems pose a serious health risk to the region’s poor.”[2] PPPs can help Governments Bridge the financing gap and leverage private-sector expertise.

However, what exactly are the mechanics of PPPs and why are they now so popular? Simply put, PPPs are partnerships between the public sector and the private sector with the goal of delivering goods or services traditionally provided by the public sector. To create a PPP, governments need to negotiate over the division of resources, responsibilities, and rewards between themselves and private sector firms. PPPs are seen to be attractive because they combine a profit motive that can increase efficiency with government management and accountability to prevent excessive profits. They also can, at least in theory, encourage foreign firms to transfer some of their know-how to either governments or local firms.

PPPs have become particularly popular since the 1990s, and now include sectors such as transportation infrastructure, municipal water services, and healthcare delivery. However, are PPPs the magic solution governments have been hoping for? Not necessarily. Critics have labeled PPPs giveaways to multinationals and denounced the privatization and market pricing of public goods. As a Harvard Business School case study notes, “The apparent outsourcing of regulatory responsibilities troubled critics, who warned, ‘PPPs may achieve cost reductions at the price of democracy and equity.’”[3]

Of course, PPPs do not only present possible problems for governments, but they could also entail significant risks for firms, including those associated with potential changes in government administrations or changing government priorities, unrealistic timelines, failure to meet commitments, and a need to accommodate a substantial number of stakeholders on either side. Changes in government, its policies, or its priorities are risky for firms in PPPs, because such changes could lead to abrogation of the PPP agreement by the government. Sometimes governments may go so far as to demand alterations to the agreement after it has

---

[2] http://www10.iadb.org/intal/intalcdi/PE/2012/12138.pdf
[3] Daemmrich, Arthur A. and Ian McKown Cornell. (2012). *GlaxoSmithKline in Brazil: Public-Private Vaccine Partnerships.* HBS 9-712-049. Boston, MA: Harvard Business School, p. 6-7

been signed, which puts firms, many of whom partake in PPPs to enhance their public image, in an extremely difficult position.[4] Still, firms cannot ignore the benefits of PPPs that can help them with market entry and create a sustained commercial presence in some of the largest or fastest growing markets in the world.

In view of these tradeoffs, can governments successfully employ PPPs to promote business and strengthen their economies? What can they do to maximize the rewards while minimizing the risks of such deals? What strategies can they utilize to make PPPs more enticing for businesses, without giving up too much? Let us examine a real-world example from Brazil and discuss some key takeaways.

In 2009, the pharmaceutical company GlaxoSmithKline (GSK) signed a PPP agreement with the Brazilian Oswaldo Cruz Foundation (Fiocruz), in which GSK promised to transfer the technology and know-how for manufacturing complex meningitis and pneumonia vaccines to Fiocruz. In return, Brazil's Health Ministry agreed to buy the vaccine exclusively from GSK for a ten-year period for use in government-sponsored immunization programs. The deal also included joint funding of research and development for a vaccine to combat dengue fever, a significant health concern in Brazil.[5]

The benefits of the PPP for both sides were clear. GSK would likely exceed 500 million euros worth of vaccine sales, enjoy an opportunity to learn how to work with Brazil's government, and learn how to operate in its market, and strengthen its image. Brazil would gain the capability of manufacturing a first-rate vaccine at nominal cost for use in its domestic market or potentially even for exporting to other Latin American countries.

How did the Brazilian government manage to conclude such a successful deal? First, in this case the high cost of doing business in Brazil—a result of high interest rates, inefficient taxes, poor infrastructure, and red tape—likely benefited the government by making the PPP, and the chance to avoid some of these costs, more enticing for GSK. Other countries with markets that have high political barriers to entry may also be able to take advantage of this to

---

[4] Daemmrich, Arthur A. and Ian McKown Cornell. (2012). *Teaching Note - GlaxoSmithKline in Brazil: Public-Private Vaccine Partnerships.* HBS 5-713-044. Boston, MA: Harvard Business School, p. 6

[5] Daemmrich, Arthur A. and Ian McKown Cornell. (2012). *GlaxoSmithKline in Brazil: Public-Private Vaccine Partnerships.* HBS 9-712-049. Boston, MA: Harvard Business School

make PPP agreements more enticing to firms. Next, Brazil achieved political stability and sustained growth in the 2000s, decreasing risks associated with changes in government. Furthermore, it had built trust between Fiocruz and GSK through previous deals and cooperation,[6] showing that it would be a reliable partner. The guarantee to buy ten years' worth of GSK's vaccine during the technology transfer period also removed significant revenue risks from the equation for GSK.

The importance of political stability and manageable investment risk is further emphasized by the failure to obtain funds for renewable energy projects in Africa. According to Achim Steiner, executive director of the United Nations Environment Program, "Public private partnerships are not working [in Africa] because of too much risk on the private investors." Others commented, "Investors need more guarantees that their projects won't suffer losses from political or legal changes in Africa's poorest nations," and, "International institutions should shoulder more of those risks."[7] High-risk countries seeking private investment through PPPs could facilitate joint investment between multilateral agencies and private companies to reduce risk for the private sector and augment the chances of securing financing.

A 2011 study by the Economist Intelligence Unit that evaluates the environment for PPPs in the Asia-Pacific agrees on the importance of the investment climate, using it as one of its indicators. Other factors considered by the study to be important for an environment amenable to PPPs include a country's legal and regulatory framework, quality of institutional design, operational maturity, public capacity to plan and oversee PPPs, and financial facilities, among others.[8]

This clearly shows that not only a government's ability to entice private sector firms into PPP agreements, but also its public sector capacity and implementation experience, strong institutional frameworks, and communication between partners are vital to the ultimate success of PPPs. PPPs have the potential to drive much-needed investment and efficiency gains

---

[6] Daemmrich, Arthur A. and Ian McKown Cornell. (2012). *GlaxoSmithKline in Brazil: Public-Private Vaccine Partnerships.* HBS 9-712-049. Boston, MA: Harvard Business School, p. 7.
[7] http://www.bloomberg.com/news/2013-01-17/africa-renewable-energy-push-not-working-due-to-risks.html
[8] The Economist Intelligence Unit. (2011). *Evaluating the Environment for public-private partnerships in Asia-Pacific: The 2011 Infrascope.* Retrieved August 2014 from http://graphics.eiu.com/upload/eb/Infrascope202011_Asia.pdf.

in countries worldwide, but governments must take steps to ensure successful planning and implementation of such agreements.

Note: I would like to thank Elizabeth Vissers for research assistance on this article.