

4. Defining the project and the contract

Outline of this Module

What this Module does:

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

Who should read this Module:

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

4.1 Scoping consultancy projects

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

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

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

Table 4-1

Officials involved in scoping decisions

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

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

Advisors should be phased in, recognizing their different skills

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

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

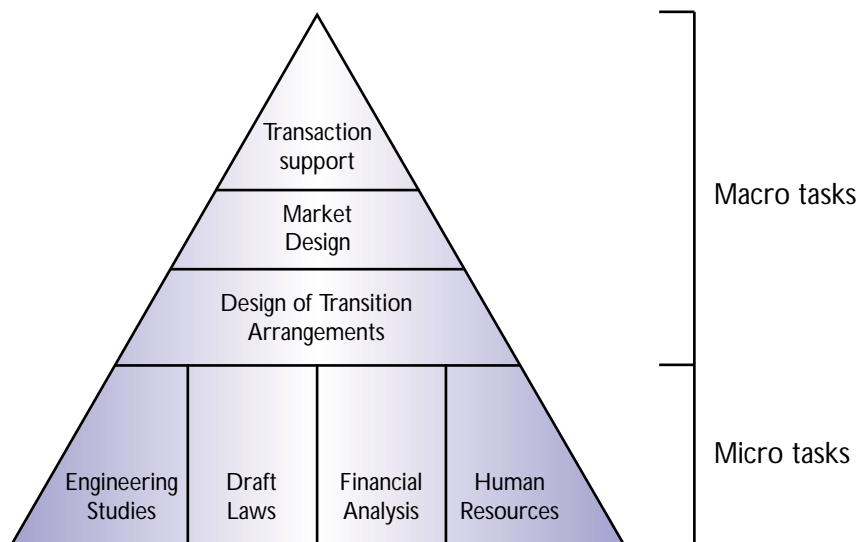
- Management, economic and technical consultants undertake higher level (macro) tasks (e.g., defining structures, transition arrangements, mechanisms, regulatory and other frameworks) and are more likely to be usefully involved from the beginning.
- Legal, human resource and financial consultants generally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

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

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

Figure 4-1

The advisory pyramid



Governments should specify the skills they need

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

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

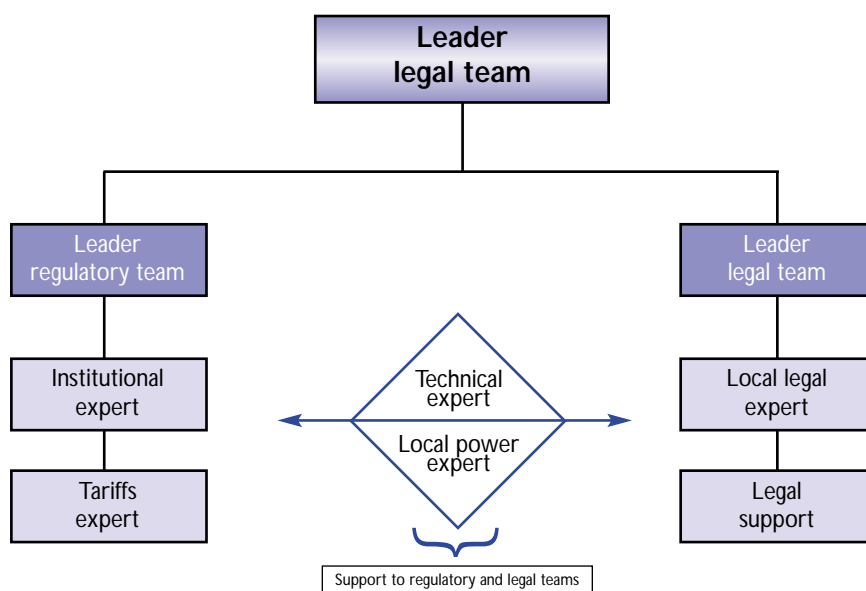
Figure 4-2 presents an example of a possible team structure based on one of the sample ToR from the Annex to Module 7, *Volume III*. Although there is no single correct way to present a team; in general the ToR will indicate:

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

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

Figure 4-2 Indicative team

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



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

Setting a realistic timetable

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

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

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

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

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

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

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

Figure 4-3
Indicative idealized timetable

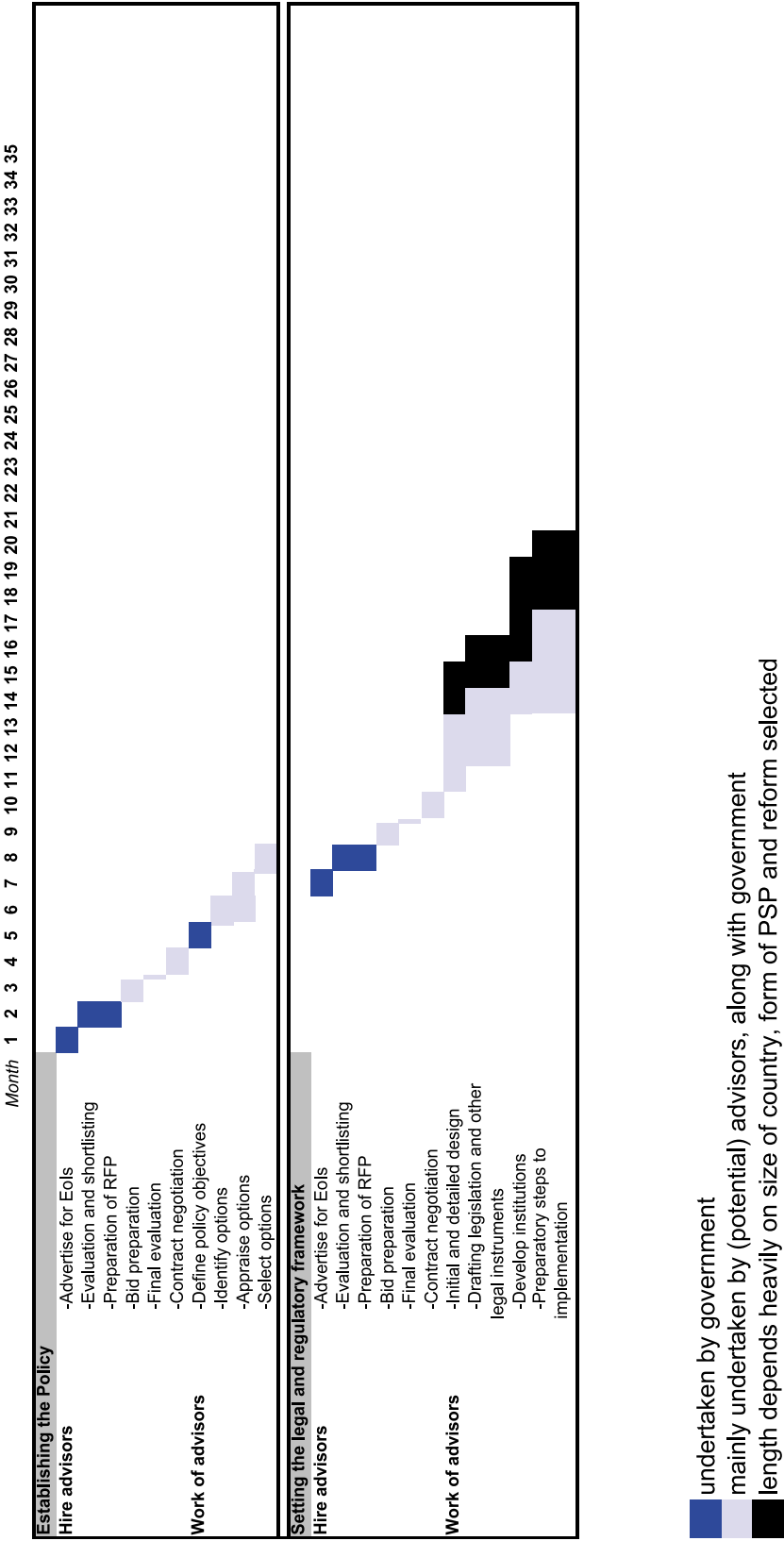
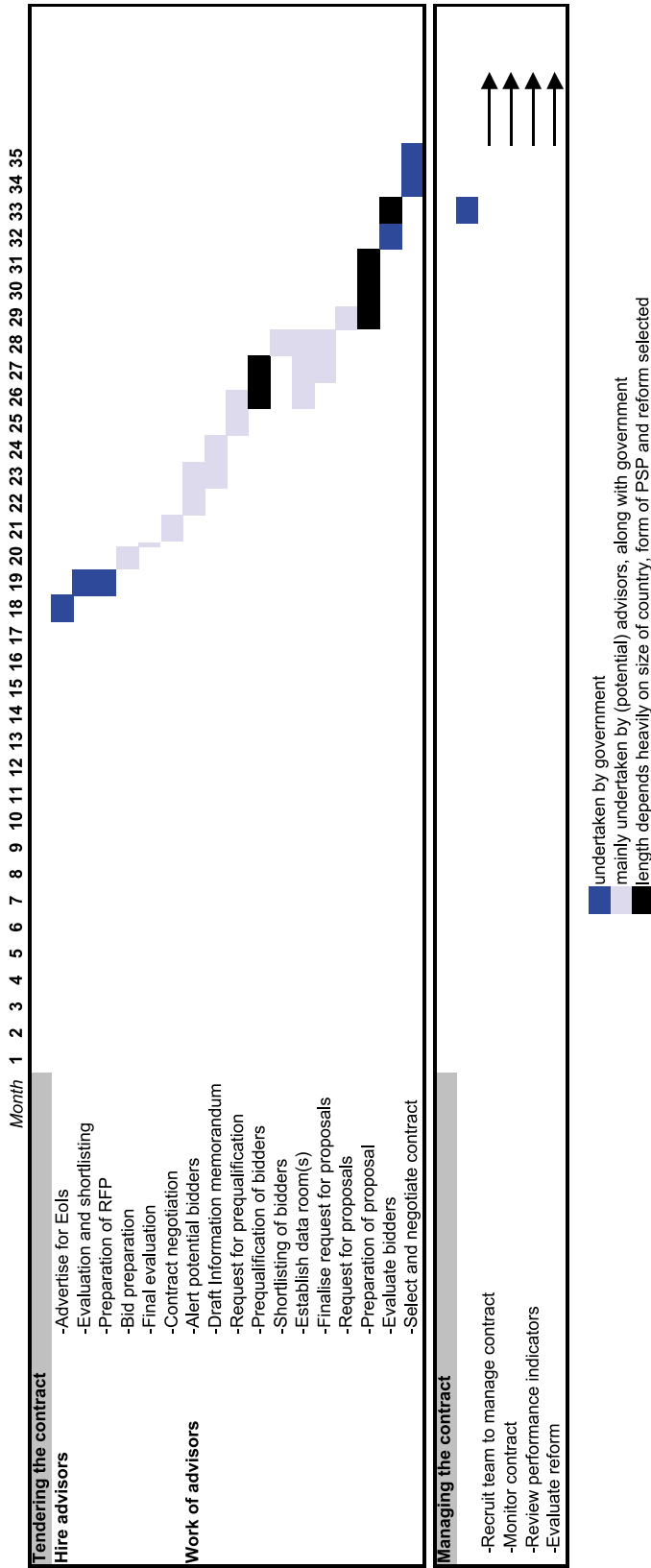


Figure 4-4
Indicative idealized timetable



Ensure that the budget matches its requirements

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

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

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

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

Table 4-3

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

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

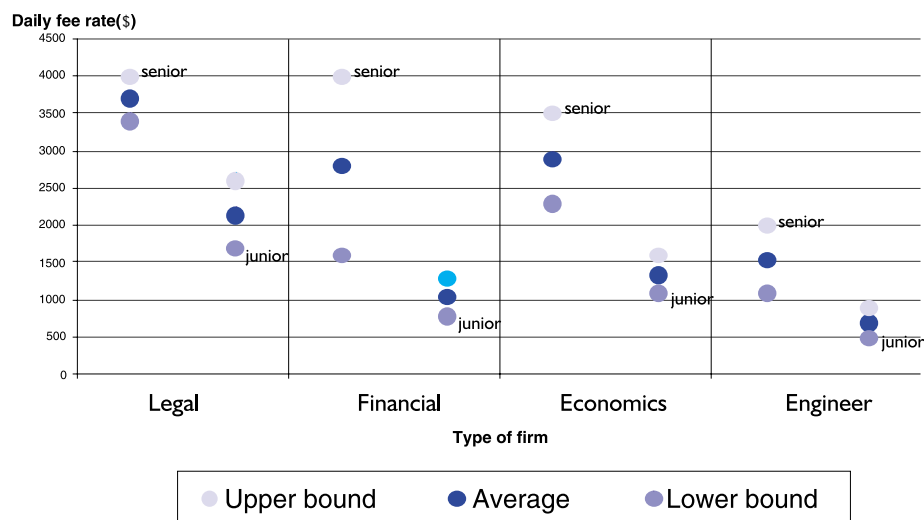
* Fee rates for each position are based on expected years and type of experience. It is clearly possible for someone with very limited experience to set up a company and call themselves a partner. This does not mean that they should be given the fee rates quoted for partners or directors in this table.

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

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

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

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



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

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

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

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

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

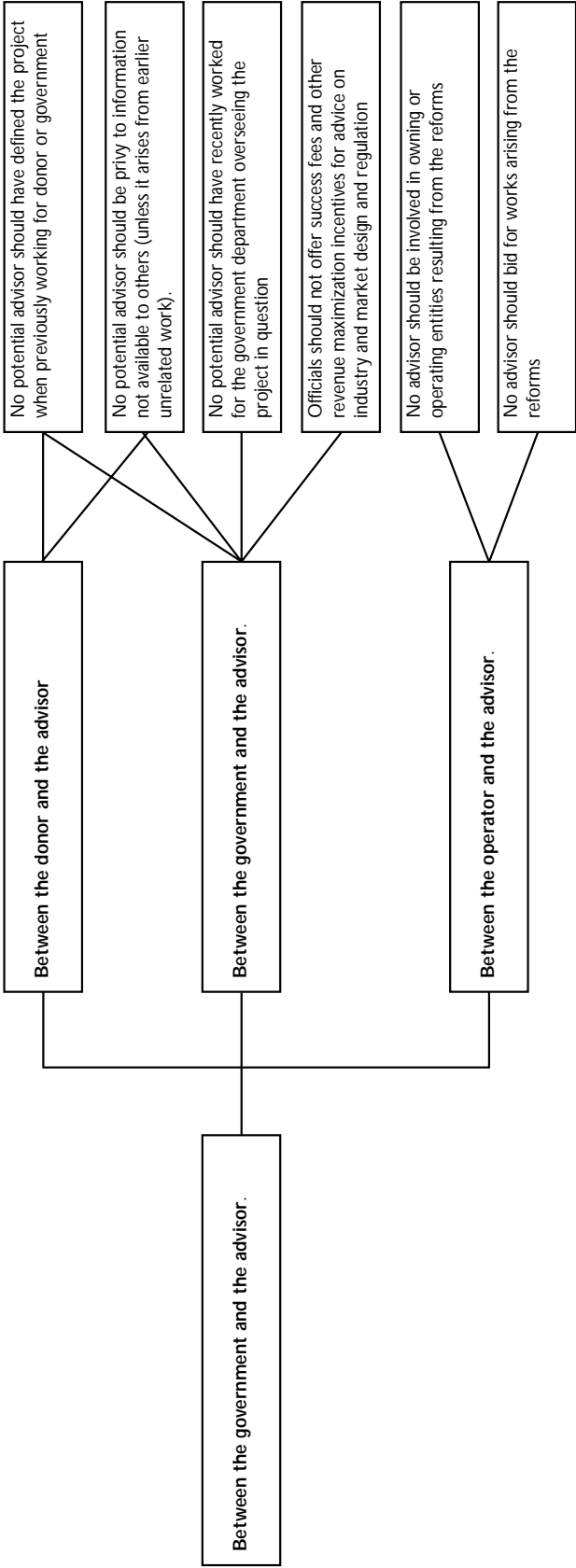
4.2 Resolve conflicts of interest

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

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

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

Figure 4-6
Potential conflicts of interest



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

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

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

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

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

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

Disqualification of advisors

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

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

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

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

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

Shared use of advisors in South Africa

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

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

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

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

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

The potential for scope-creep

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

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

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

4.3 Payment methods need to balance security and incentives

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

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

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

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

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

4.4 Advisory services can be packaged

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

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

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

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

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

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

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

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

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

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

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

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

4.5 Meeting constraints

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

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

¹⁷

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

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

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

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

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

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

Useful reading

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

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