

## 5. Use of advisors for small-scale projects

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### Outline of this Module

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#### *What this Module does:*

This Module outlines the special features of selecting advisors for smaller scale projects—either projects in small countries or in small political units of larger countries (e.g., municipalities). The Module outlines the main challenges in hiring advisors in small countries and how best to overcome those challenges. It also examines the implications of smaller projects for the stages of the PPI process.

#### *Who should read this Module:*

Leaders and officials of small countries, local communities and regions where the reform of relatively small systems is being contemplated should read this Module.

### 5.1 Definition of a small project

There is no single definition of a small region or small project. The British Commonwealth uses a threshold based on population to define small countries. All those with a population below 1.5 million are considered small and a few additional states are also included because they have characteristics similar to small states (e.g., Jamaica, Lesotho, Namibia and Papua New Guinea). Other organizations use similar definitions. For more detail see Further Readings.

There are two primary kinds of small PPI projects: those in small countries and those being developed at a community level. The difference will affect the method of hiring advisors and the attractiveness of the project to the market. The sections below address the implications for advisors being hired to work in each of these environments.

#### ***Small country* → *small project***

The typical characteristics of projects that are small because of country size are:

- **remoteness and insularity** – e.g., Mauritius, Maldives and many Pacific island states are located far from major markets, making it more expensive for investors to transport needed materials;
- **limited institutional capacity** – small states find it more difficult to meet the fixed costs associated with building some civil society institutions increasing the risk to investors (e.g., through the lack of a regulatory framework); and
- **limited diversification of production**—small states often have a small resource base and industrial sector concentrated in a few areas, thereby increasing the risk to investors of any adverse market conditions.

#### **Difficulties of smallness**

Kiribati has a population of around 80,000, spread over a region roughly the size of Europe. Most of this area is ocean, further challenges the country's infrastructure: transport across the country is difficult, communications and power development are poor, and there is a lack of secure, nonsaline water.

The nearest large markets are 4,000km away in Honolulu and Brisbane. The resource base is small, with little potential for agriculture. The survival of the economy rests on

fishing, which accounts for the livelihood of around 80% of the households and is a major source of foreign exchange. This is used to purchase other necessities.

These conditions may require a different approach to attracting investment for infrastructure. Small systems and local participation with minimum regulatory requirements would be key ingredients of a PPI program, and the scope and size of advisory services would have to be tailored accordingly.

Source: Small States: Meeting challenges in the global economy, World Bank, April 2000.

### **Community → small project**

Even within large countries, there may be a range of small projects undertaken by local communities—municipalities, towns, cities and even regions. These projects face similar problems to those outlined above but also have their own specific qualities, including:

- the potential for support from a larger governmental entity for PPI programs; and
- more restrictions as a result of national policy and law. For example, while stage 1 of the PPI process, as described in Module 2, consists of establishing the policy, it is unlikely that a project undertaken by a local community will change national policy.<sup>18</sup> Under these conditions, much of stage 1 can be omitted, whereas a similarly small project undertaken by a small country should consider stage 1.

The reasons for a project being small will affect the cost of advisors, stages of project implementation, and the use of advisors. Each of these is discussed in Sections 5.2 below.

#### **5.1.1 Cost and small projects**

Module 4 presents indicative costs for technical advisory services. Regardless of the project size, the agency responsible for the PPI project will want to minimize costs. This is one of the main justifications for the competitive bidding procedures described in Module 7 in *Volume III*. However, for smaller projects, the need to decrease the costs of technical assistance and other costs associated with PPI is more apparent for two reasons:

- (1) **Upfront costs** Governments in charge of small projects usually face more severe fiscal constraints than larger government entities. As a result, even if the implementation of the PPI program will raise substantial revenue, the government may not want to spend large amounts up front on advisory services.
- (2) **Cost-benefit tradeoff** For very small projects, the tendering of large advisory contracts, including international roadshows and extensive modeling, may result in the costs outweighing the benefits of the PPI.

Consequently, smaller projects must look for ways to minimize the costs of technical advice, while ensuring they receive the advice required for a successful PPI program.

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<sup>18</sup> In some cases, projects undertaken by municipalities, such as the water concession in the small town of Limeira, Brazil, may subsequently be regarded as examples of best practice and as such may affect national policy.

## 5.2 Project implementation

### **Small country** → **small project**

A small country implementing, or anticipating, infrastructure reform should still consider each of the steps for project implementation outlined in Modules 2 and 3. In particular, it should:

- **establish the policy (stage 1)**, clearly identifying both the government policy and appraising alternative options for meeting the policy requirements;
- **set the legal and regulatory framework (stage 2)**, designing and drafting the requisite laws and institutions;
- **tender the contract (stage 3)**, alerting, informing and contracting potential investors; and
- **manage the contract (stage 4)**, monitoring the implementation of the project.

The main savings in this case come not from omitting or combining tasks but from combining and simplifying the role of advisors. This is discussed in Section 5.3.

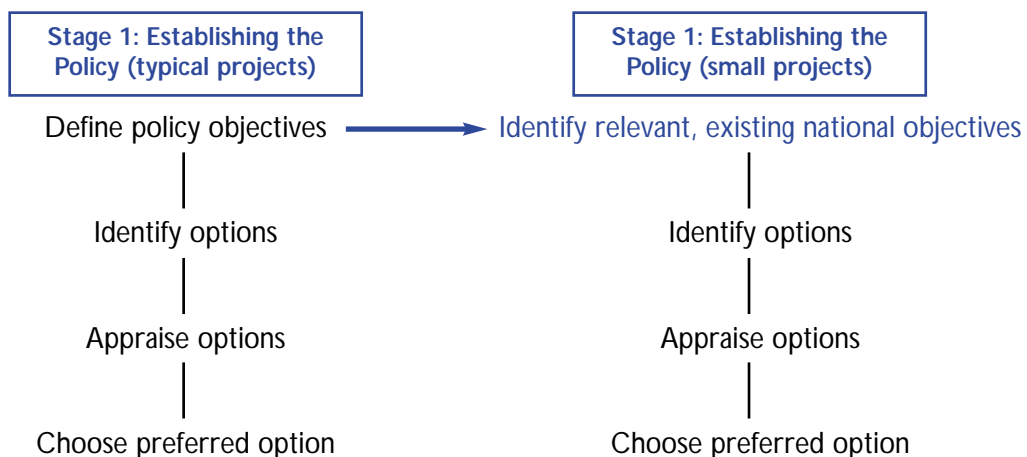
### **Community** → **small project**

Projects that are small because they are undertaken at a sub-national level will be able to shorten, adjust and, in some cases omit, some of the steps outlined in Figure 2-1. Figure 5-1 to Figure 5-4 outline the main changes to the steps outlined in Figure 2-1. The timeframe for the whole process (and therefore for individual steps) will also change. In particular, stages I and II should be considerably shorter because:

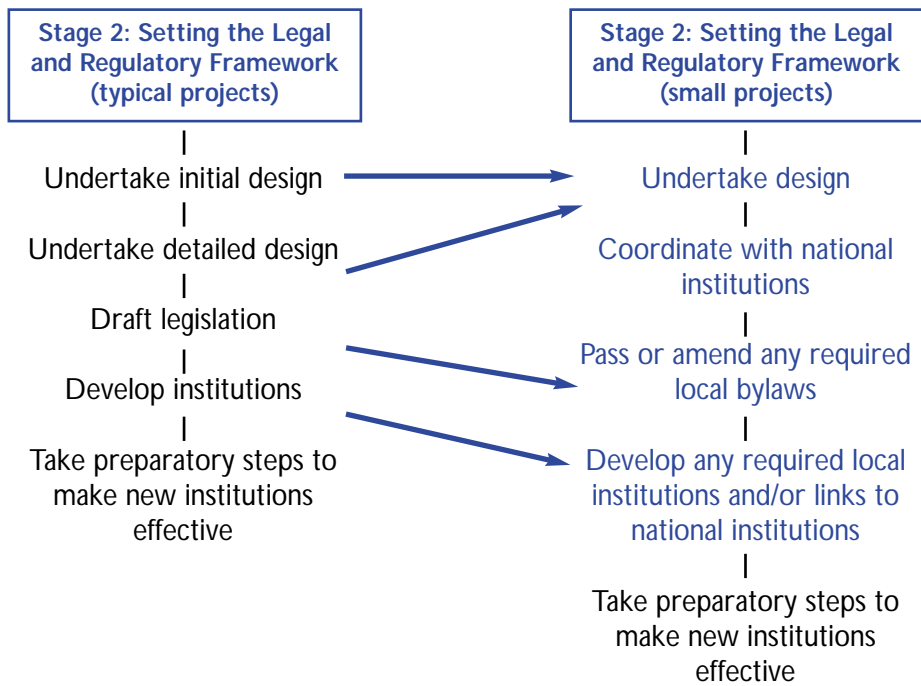
- the identification of the relevant national policies is faster than drafting new national policies;
- the range of options to appraise is likely to be smaller;
- the design of the project is likely to be less complex;
- except in unusual circumstances, any new legal drafting should be straightforward (e.g., projects may necessitate changing local designations for land from residential to commercial but should not require major legal drafting); and
- the government should minimize the creation of local institutions, with tasks assigned either to national institutions or dealt with in contracts between the local authority and the new investor (which are then enforced by national courts).

**Figure 5-1**

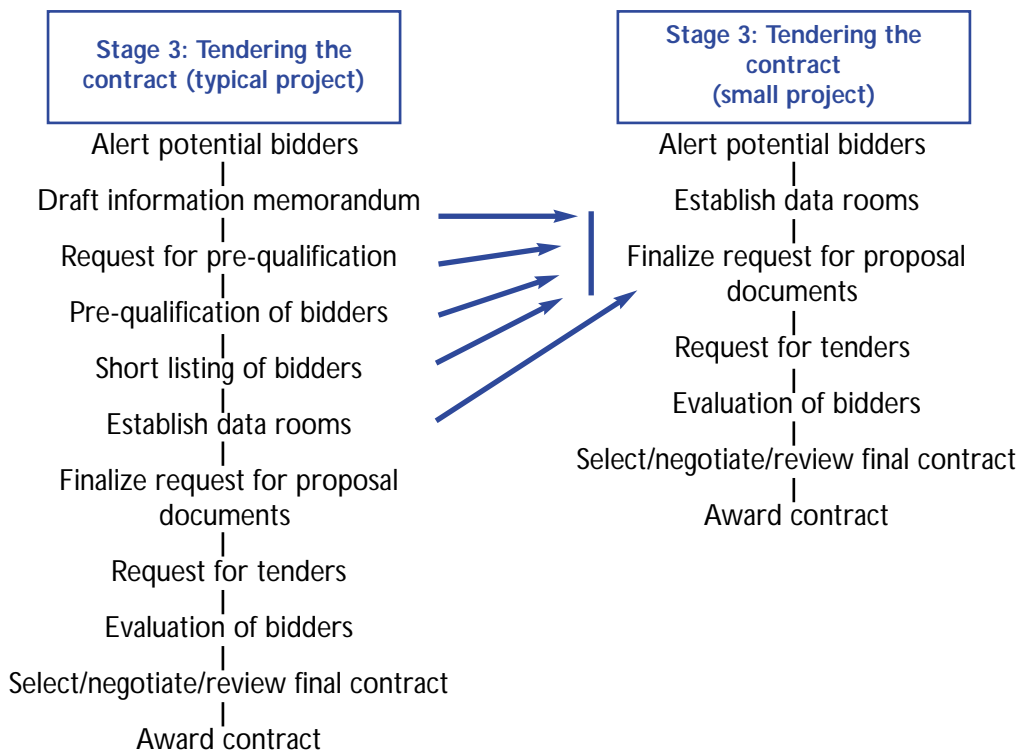
Changes to stage 1 (changes indicated in blue)



**Figure 5-2**  
Changes to stage 2 (changes indicated in blue)

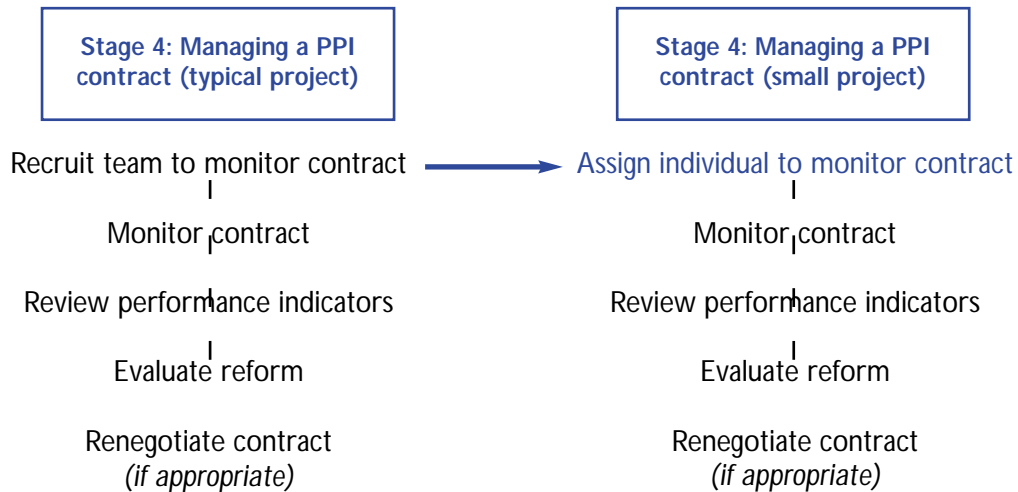


**Figure 5-3**  
Changes to stage 3 (changes indicated in blue)



**Figure 5-4**

Changes to stage 4 (changes indicated in blue)



### 5.3 Role of advisors

Module 3 outlined the role of advisors in each stage of a PPI project. This section outlines areas in which small projects can lower advisory costs in some of these stages. In addition to eliminating some stages and combining others, advisory costs for small systems can be lowered by recognizing that:

- the use of some types of advisors are unnecessary; and
- the resources required for advisory services need to be scaled down.

#### Targeting potential advisors appropriately

Recently, a small country in Eastern Europe issued a request for proposals to privatize its telecommunications company. Because the company was to be privatized through a public offering, with the majority of shares likely to be bought by a single strategic investor, only investment banks were invited to bid. However, because of its small size the privatization did not interest the investment banks, none of which submitted a proposal.

A better process would have recognized that the skills required for a small initial public offering can be found outside investment banks. Shortlisting based on skills would have probably included the larger management consultancies, in addition to the smaller investment banks, resulting in more bids.

The main savings will come from two areas.

- **Eliminating the need for some advisory services** Some steps, including detailing the regulatory framework, establishing the regulator, drafting legislation and undertaking investor surveys, may be unnecessary at the community level. While small nations may not be able to eliminate as many advisory roles as community-based projects, they can combine advisory services across many sectors.

- **Combining some advisory roles** While larger, more complex projects require specialist economic, financial, legal, and technical advisors, some of these advisors may be able to take over roles usually performed by others in smaller, less complex projects. For example, Lesotho's Privatization Unit has used management consultants to conduct transactions.

There is another area in which savings can be made: some of these advisory roles may no longer require external advisors. For example:

- state and central government officials with previous experience (and contact with advisors) can undertake some of the tasks (e.g., selecting the appropriate form of PPI, drafting information memorandum, shortlisting);
- using existing material (e.g., model contracts) may reduce the role of advisors (see Module 4 for more detail); and
- in the case of smaller states, the government may use staff within donor agencies who can provide initial guidance on the appropriate approach to adopt or even assist with the transaction.

### **5.3.1 Eliminating the need for some advisory services**

In addition to the reduction of tasks outlined in Section 5.2, the total input from advisors can be reduced by taking advantage of centralized procurement strategies. The first involves procuring services required by a number of communities or small states from one central source. In addition to spreading the fixed costs, centralized procurement:

- may reduce total costs if there are economies of scale in either the procurement or provision of services;
- may increase the interest of established advisory firms that otherwise would not be interested in a single small project;
- creates greater communication among communities and between communities and the national government; and
- provides a forum in which to disseminate advice and experience.

Similarly, grouping PPI reforms across smaller nations can create cost savings both during the advisory stage and during implementation. It may also attract more private sector interest because it is possible to offer larger projects.

### **Grouping PPI**

#### *Grouping across countries—The East Caribbean States*

The five member countries of the Organization of East Caribbean States (St. Lucia, Dominica, Grenada, St. Vincent and the Grenadines, and St. Kitts and Nevis) have adopted a new approach to liberalizing their telecommunications sectors. Each island nation considered itself too small alone to undertake the necessary advisory work and reforms. They are therefore undertaking the reforms together.

They received a total of US\$6 million in financing from the IBRD and IDA to undertake the reforms. The result is a regional telecommunications regulator, the Eastern Caribbean Telecommunications Authority (ECTEL). In order to maintain national sovereignty, powers over licensing and regulation remain with each country but the ECTEL will provide technical expertise, advice and support to coordinate regulation across the countries. The ECTEL will also help to ensure that the PPI process is transparent, competitive and protects the interests of consumers. Some OECS state are now pursuing the regional regulatory concept for water, power and broadcasting.

Source: Small States: Meeting Challenges in the Global Economy, World Bank, April 2000.

### 5.3.2 Combining some advisory roles

In addition to the methods described above, combining some specialized tasks may reduce advisory costs.

Module 3 outlined in detail the skills required at each stage of PPI. Figure 5-5 outlines how the skills required at each stage of the PPI process can be combined in areas where smaller projects allow sufficient overlap to permit one specialist to assume the role of another.

**Figure 5-5**  
Amalgamation of advisory roles

Stage 1: Establishing the Policy	Stage 2: Setting the Legal and Regulatory Framework	Stage 3: Tendering the contract	Stage 4: Managing a PPI contract
Advisors for typical project (see Module 3)			
Economic Financial Legal Technical	Economic Financial Legal Technical Environment Pension HR	Economic Financial Legal Technical Environment Pension HR Procurement	Economic Financial Legal Technical HR
Potential result of amalgamation of advisory roles			
* undertaken internally, either by Economic Technical	local or national government Economic Legal Technical	Financial Legal Technical	None* or Legal

### **Water privatization in the Windward Islands: A case of scaling down to match the limited resources of an island economy**

In preparing for the privatization of its water utility, the government of a Caribbean island nation of 150,000 citizens recognized the need to hire technical advisors to assess the sector's long-term investment requirements. The foreign engineering consultant advising the government on the scope of investment needs determined that the assessment should consist of several sub-components, analyzing possible options for such variables as network linkage between different regions, extension of distribution pipes, and development of sewerage systems in most of the island's communities. The proposed assessment called for teams of several engineers and professionals, -including sanitary engineers, mechanical engineers, electrical engineers, economists, and a geologist -providing nearly 1000 person days of work and costing over US\$800,000.

While it was imperative that the government conduct an investment needs analysis to determine average tariffs and to carry out a successful transaction, the scope and cost of this analysis threatened to overwhelm the government's resources. The government determined that the study as described would be too complicated and costly given its restricted resources. Accordingly, the design of the study was modified: the technical advisors will rely on an outline engineering appraisal to derive cost estimates for each variable, and will not assess all possible options or verify some assumptions used in the appraisal. Re-scoped, the final technical analysis will cost closer to \$250,000 and will be closely coordinated with the financial work in order to maximize economies of scope with the transaction advisors.

A final option available to all small projects is the use of the potential investors to reduce the cost of the PPI process. Many potential investors have consultancy divisions that may undertake many of the tasks described in Module 3 at a discounted rate because the parent company is interested in the investment opportunity. While this can be a cost-cutting option, it must be used very carefully because of the clear potential conflicts of interest involved. The only reason potential investors may offer their consultancy services at a discount is because they see a potentially profitable opportunity in the future. It is vital that impartial, experienced individuals carefully check the advice from any such consultancy before implementing any of the advice. One approach to minimizing costs may be to hire a recognized expert to review the advice received from a potential investor. Regardless of the precise approach, because of the potential conflicts of interest this route should only be adopted if the advantages of PPI are clear and other options for minimizing the cost of advisory services are not available.

#### ***5.3.3 Eliminating and combining advisory roles***

Combining similar projects—either across sectors or across municipalities or small countries—allows those overseeing small projects to eliminate some roles and combine others. It is possible to:

- eliminate repetitive tasks (e.g., the same group of investors may be contacted about several opportunities for water privatization in different towns); and
- combine similar tasks (e.g., principles of tariff design may be similar across many sectors).

### Combining Projects to Spread Costs

*Public Private Partnerships Program (4Ps), UK*

There is an extensive program of PPI (called the Private Finance Initiative because it extends beyond infrastructure) in the UK. The central government encourages each of the local authorities (community governments overseeing populations ranging from around 100,000 to about 400,000) to use the private sector to increase efficiency.

The central government recognized from the beginning that use of the private sector would entail some fixed costs, which were likely to discourage local authorities from implementing the program. Therefore, the government established a quasi-public agency, the 4Ps, to provide assistance to the local authorities and allow some of the fixed costs associated with PPI advisory services to be spread across multiple projects. In addition to spreading the costs and providing support through the PPI process, it also provides a focal point for the private sector, creating greater private sector interest in an individual project than the same project would generate had it simply been advertised by the local authority.

For more information see <http://www.4ps.co.uk/>.

*Coordinating Council for Private Sector Participation (CCPSP), Philippines*

In 1989, the Coordinating Council of the Philippine Assistance Program (CCPAP—later renamed CCPSP) was created to mobilize and use development assistance to the country. In this capacity, CCPAP supported around 100 pre-investment studies covering a wide range of infrastructure and other industries. It provided not only a central coordinating center for potential projects and for communities looking at new projects, but also provided assistance in overcoming problems of implementation.

It helped to resolve right-of-way issues, provided auditing services, ensured environmental compliance and undertook general administrative functions. These administrative functions included the creation of a computer-based project-monitoring program.

For more information see: [http://members.xoom.com/op\\_ccpsp/](http://members.xoom.com/op_ccpsp/).

**Recommendation 5.1: The size and scope of small projects alter the role, selection and use of advisors. In particular, governments should limit the cost of advisors by combining tasks and projects wherever possible.**

## 5.4 Role of the competitive tendering process

Module 7, *Volume III*, discusses the competitive selection process. There are four main points around the competitive hiring of advisors:

- It is often the best way to ensure the appropriate quality advice at the lowest price;
- It involves initial costs necessary to undertake the process (although longer-term savings are likely);
- It requires some expertise on the part of the selectors; and
- It must be interesting to a sufficient number of companies to create competition.

(For a fuller description see Module 7, *Volume III*)

However, the competitive appraisal of potential advisors for small projects will differ in a number of important ways. In particular:

- the size of the projects may limit the number of interested companies;
- knowledge of the projects is likely to limit the number of bidders; and
- lack of experience on the part of the selectors will probably require simplified submission, evaluation and contracting procedures.

Of these, the largest obstacle will be the size of the project. Small projects mean that spending on advisors must also be small if the benefits of the projects are not to be outweighed by the costs of implementation. There are a number of approaches to limiting the cost of undertaking a competitive bid:

- **National Competitive Bidding** Rather than advertising and issuing international requests for proposals, this entails a national competition. Clearly the ability to do this depends on the expertise that exists within the country. However, once combinations of foreign and local advisors have undertaken larger PPI projects then there may be sufficient local expertise to advise on the implementation of small projects.
- **Listing** A variation on indefinite quantity contracts, listing requires a central government authority to maintain a database of companies that have been used in the past or have expressed interest, along with their areas of expertise. As specific projects arise, invitations can be sent to a few companies extracted from the database. As a result, the project moves immediately to the proposal evaluation stage.

This approach also limits the costs to companies of bidding for small projects. Companies are more likely to be willing to provide relevant details once for a database than each time a small project arises. Therefore, in addition to creating databases for municipalities and towns, small states should consider combining resources to create regional databases of potentially interested companies.<sup>19</sup> It is vital that these databases are kept up to-date.

- **Coordinating** Communities or small states wanting similar services should coordinate a joint request for proposals and share the associated costs. This has the further advantage of increasing the size of the project, which will therefore attract greater private sector interest.

### Coordination of resources

In Uganda the government is setting up a Rural Electrification Unit (REU) that will be responsible for coordinating rural electrification funding and advice. Communities will be responsible for bidding for funds from the REU and those awarded funds will then benefit from the REU, which will coordinate all the projects, and provide advice and central procurement for equipment and other needs. This approach will combine the benefits of community-led PPI while using a centralized procurement strategy to allow competitive selection procedures without imposing all the costs on a single community.

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<sup>19</sup> All the major multilateral donor agencies already keep databases of registered consultancies. Since any consultancy can register (provided they meet minimal criteria) the databases should not be regarded as an endorsement of the companies and the proper selection procedures should still be carried out. However, these lists provide a starting point if, for example, a call for expressions of interest has not solicited enough interest (see The role of donor agencies in PPI for the web addresses of the organisations).

In addition to variations on the bidding process, communities should also consider whether it is cheaper to contract individuals rather than companies. Individuals may be cheaper to hire because their use simplifies the bidding process (i.e., they submit a CV and a description of how they would approach the work), and have lower fee rates. In addition, if three or four individuals are well known, the shortlisting exercise is made easier. However, it is important to recognize the limitations of using individuals. They are unlikely to be able to offer the range of services provided by a company. Individuals are likely to be more appropriate to small, focused tasks.

Finally, communities should also consider sole-sourcing projects that are so small that the savings from competitive outsourcing are outweighed by the costs of the process. However, sole-sourcing should always be approached cautiously. (See Module 7 in *Volume III* for more discussion on when to sole-source projects.)

## 5.5 Risks

The relatively small size of these projects creates some important risks. These should be acknowledged and form a basis for the design of the detailed PPI process. In particular, the level of expertise available is likely to be lower because more experienced experts and companies are attracted to larger projects. There are a number of ways of mitigating the risk of hiring bad advisors:

- by including a representative from the government or donor agencies with past experience of similar projects on the evaluation and project management team (e.g., a representative of the state or central government with experience of previous programs for municipal projects; and a representative from a donor or the region for small nations' projects);
- by asking for previous reports, presentations and other references from the proponents; and
- by providing the advisors with incentives to perform well (e.g., a bonus partly contingent on successfully implementing the project, see 'How to select and manage PPI advisors').

### Useful Reading

Franceys, R. *Private Participation in the Water and Sanitation Sector*, UK Department for International Development, Occasional Paper #3, 1997.

Gopal, G. *Procurement and Disbursement Manual for Projects with Community Participation*, World Bank Discussion Paper 312, 1995.

Commonwealth Secretariat and World Bank Joint Task Force on Small States. *Small States: Meeting Challenges in the Global Economy*, 2000.