THE ROLE OF THE INSIDE SPONSOR
IN
PRIVATE INFRASTRUCTURE DEVELOPMENT

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1 STRUCTURE AND FUNCTIONS OF IIFC

1.1 The Inception of IIFC

The Government of the People's Republic of Bangladesh (GOB) has the policy of infrastructure projects being carried out through the private sector. The Private Sector Infrastructure Development Project (PSIDP) under which the Infrastructure Investment Facilitation Center (IIFC) was created, has two components, project financing and transaction development. The financing component is through a US$225 million fund to be on-lent by the Infrastructure Development Company Ltd. (IDCOL). The transaction development role is carried out by IIFC by assisting the government in establishing sound policy and regulatory frameworks and carrying out project development work. In essence, IIFC was created as a sponsor for developing the front-end stages of investment projects. IIFC was established with the long-term objective of establishing an efficient window for public-private interface. The intention of IIFC was not to encroach on the technical and contracting functions of the agencies, but to support their efforts by providing high quality professional expertise where required. It would develop a reservoir of knowledge to sustain the private infrastructure programme and in this respect, would be a "peddler of knowledge, not a peddler of influence".

1.2 Formation of IIFC

IIFC was incorporated as a company limited by guarantee under the Companies Act 1994. The company was established with support under the following agreements:

1. Development Credit Agreement between the Government of the People's Republic of Bangladesh (GOB) and International Development Association (IDA).
2. Agreement between GOB and the government of United Kingdom (DFID).
3. Memorandum of understanding between GOB and the government of Canada (CIDA).

The above agreements would provide financial support for a period of three years. A no-cost extension of one year has subsequently been made.

IIFC's vision is to increase infrastructure development significantly, in order to support sustainable growth of Bangladesh. IIFC Mission is to be recognized globally as the Bangladesh center of excellence in infrastructure investment and to foster Bangladesh's economic development by promoting and facilitating private investments in infrastructure development. The main objectives of the company are:

- To introduce, promote, assist all forms of private sector participation in Bangladesh for the development and improvement of infrastructure sectors: power, energy, telecommunication, water, waste-water, transportation, water management and municipal services.
- To assist and advice ministries, government departments, agencies and other public sector bodies in Bangladesh with the identification, prioritization, preparation, evaluation, award and implementation of infrastructure projects in which the private sector may participate.

1.3 IIFC Organisational Structure

The company is managed by a 7-member Board of Directors, with three directors from the public sector, three directors from the private sector and one director being an ex-officio member. The chairman is the secretary of Economic Relations Division (ERD) under the ministry of Finance. Although it has a total planned strength of 17 staff, it presently engages 8 staff. It has operated primarily through managing consultants provided by donors, DFID and CIDA.

1.4 Donor Support

IIFC is supported by two consortiums of donor-funded consultants for carrying out the investment and non-investment projects, business development work, promotional activities and institutional and capacity building. DFID, UK and CIDA, Canada are providing fund support for the consultants. DFID has appointed KPMG and CIDA has appointed CBIC as the consultants. IIFC has call-down arrangements with the consultants for rapid mobilisation from the date of engagement by a line ministry or agency.

1.5 World Bank and Government Support

In addition to its donor resources from CIDA and DFID, IIFC has received support from IDA for consultants and IIFC establishment costs and GOB provides support towards IIFC's establishment costs.

2 WHAT IS AN INSIDE SPONSOR IN PRIVATE INFRASTRUCTURE PROJECT DEVELOPMENT

2.1 Development of Public and Private Infrastructure Projects

An infrastructure project may be carried out through either conventional or public financing (a "Public Infrastructure Project") or through private financing (a "Private Infrastructure Project"). A Public Infrastructure Project is typically financed, owned and operated by government authorities or utilities. A government authority or agency is responsible for executing the project and operating it after commissioning. Since the government will own the project, the executing agency of the line ministry acts as the government's sponsor or developer, as well as operator for the project. These can be represented by the following phases in each infrastructure project:

- The Development Phase - comprising project identification, preparing concept papers, feasibility studies, seeking government and donor financing, and facility construction.

- The Operation Phase - comprising operating the facility, collection of revenues and timely maintenance of the assets.

It is generally accepted that a government executing agency in many countries is unable to properly operate an infrastructure facility in the Operations Phase. Simplistically, this is due to low revenue collection arising from high system losses or inability to collect from sister government agencies and rundown of assets due to lack of timely maintenance. What is generally less appreciated is that a government executing agency may not be appropriate in the role of a government's sponsor or developer during the Development Phase. Some of the reasons for a government agency having difficulty as a project sponsor are provided below:

- Inappropriate project identification process
- Lack of experience in project development
- Lack of commercial focus
- Change in project personnel

- Slow engagement of consultants
- Low-in-house skills for project development

While for the Operations Phase, a poor operator is evident from operating losses, for the Development Phase, this manifests in two directions – time overrun, usually referred to as implementation delay and cost overrun.

A Private Infrastructure Project is defined as one in which the development, engineering, financing, procurement, construction and commissioning is carried out through a Private Infrastructure Project developer, investor or sponsor (**the "Outside Sponsor"**). Such a project is usually project financed, also called off-balance sheet financing. The project assets and cash flow from it are used for the placement of debt finance. This type of financing differs from corporate financing or sovereign financing which is on the basis of the borrowers' balance sheet. Project financing usually entails detailed contractual relationships and obligations. In this respect, the <u>examination of the fundamentals of a project</u> is better in a Private Infrastructure Project, when compared to a Public Infrastructure Project.

However, an Outside Sponsor is unable to carry out the full Development Phase activities due to infrastructure projects generally being some form of monopoly or limited entry, necessitating on the part of government, <u>to bid out the project</u>. The activities in the Development Phase related to project identification, feasibility study, development of contractual framework and allocation of risks, assisting in negotiation process with the Outside Sponsor, requires specialist skills within a government-owned entity (**the "Inside Sponsor").** These skills may not be available in each of the government executing agencies dealing with private sector infrastructure development.

A non-infrastructure project can be taken up by private sector investors at any time, provided normal government approvals are obtained. There is no contractual link between the government and the private investors. Private investors are "free" to undertake a non-infrastructure project in accordance with market demand. There is no bidding for non-infrastructure projects. For example, investors can take up a cement factory at any time, without having to undergo a bidding process.

An infrastructure project cannot be taken up by private sector investors whenever they want. There is a strong contractual link between the government and the private investor through a security package encompassing defaults, buyouts, termination provisions etc. Private investors are not "free" to undertake an infrastructure project in accordance with market demand. For example, even though there is acute shortage of power, private investors cannot build power plants until the government requests bids or the market is unbundled. A Line Ministry has to bid out infrastructure projects (neglecting unsolicited proposals which are non-transparent). If Line Ministries do not bid out infrastructure projects, the private sector investors cannot come forward. This is the central bottleneck to all private sector investment in infrastructure. Removing this bottleneck will achieve much greater levels of PSP in infrastructure.

2.2 The Seven Stages of Private Infrastructure Development

A Private Infrastructure Project when taken through a solicitation process, and assisted by an Inside Sponsor, will typically follow the seven stages of project development illustrated in Figure 1. To the extent possible, the Inside Sponsor should match the technical, financial, commercial, legal and negotiation skills of the Outside Sponsor. In addition, the speed and flexibility of employing good consultants should be similar.

In Stage 0, the business development phase, the Inside Sponsor after discussion with the Line Ministry or Agency will select a Private Infrastructure Project. Project recognition skills are extremely important for an Inside Sponsor, other wise much time an effort is wasted for a long time. Unless this time and effort is tied to success, project recognition skills will not be commercially driven. Government approval for carrying out the project under private sector is obtained through signing a Development Services Agreement (DSA) between the government agency and the Inside Sponsor (please refer to Figure 2). A DSA may take between two months to one year, and in some cases may take two years.

In Stage I, the Inside Sponsor engages its own staff and consultants, who may be expatriate and local, to carry out the feasibility study. As for Outside Sponsors, who are able to deploy consultants very rapidly, Inside Sponsor should also be able mobilise very quickly, consultants who are experienced in transactions. Rapid consultant deployment (IIFC target of one month) can be achieved by using consultant draw-down arrangements. In contrast, deployment of IDA funded consultants may take between 12 to 18 months and hence its use is limited for an Inside Sponsor.

Stage II relates to preparing the contractual framework and is the most critical phase. In situations where precedence for private investments does not exist and the approval process is unclear, government decisions at various levels are sometimes slow. Lack of knowledge and experience compounds the problems. In this stage, the risk allocation between private and public sector takes place, through designing the concession agreement.

In Stage III, project promotions take place, bidders are shortlisted, bids received and evaluated. This stage ends with the identification of the potential Outside Sponsor. Stages III and IV represent the handover phase from the Inside Sponsor to the Outside Sponsor.

In Stage IV, the Inside Sponsor assists the government agency to negotiate the project with the potential Outside Sponsor. This is carried out through support in technical, commercial, financial and legal assistance. This stage ends with the concession agreement being signed with the Outside Sponsor (please refer to Figure 2). It is evident from Figures 1 and 2 that *the Inside Sponsor provides sponsorship and invests time, money and effort from Stages 0 to IV* while the Outside Sponsor takes up the responsibility from Stage IV onwards.

Figure 1: Key Stages in Project Development

	Stage 0	Stage I	Stage II	Stage III	Stage IV	Stage V	Stage VI
	Business Development	Feasibility	Commercial Framework	Evaluation	Negotiation	Financing	Construction
Stage Completion Milestone	DSA Signed	Feasibility Study Completed	Issue Request for Proposal (RFP)	Issue Letter of Intent (LOI)	Sign Agreement	Financial Closure	Start of Commercial Operation
Processes and Actions	•Select project meeting criteria: -GOB commitment -bankability -project size -other competing projects •Prepare & submit Development Services Agreement -DSA •Sign DSA between Ministry/agency and **Inside Sponsor**	•Inside Sponsor engages consultants •Elicit project ideas •Define the need •Identify and agree major technical and transaction parameters •Complete feasibility study	•Develop action plan •Select project concepts •Prepare commercial framework •Obtain Ministry agreement for Pre-qualification documents •Obtain Expressions of Interest and shortlist •Prepare Model Agreements •Prepare bidding documents •Issue RFP	•Hold bidders conference •Shortlisted bidders prepare bids •GOB receives bids and prepares evaluation report •GOB approval of successful bidder •Issue LOI to successful bidder	•Prepare for negotiations •Carry out negotiations between Sponsor and GOB entities •Signing of agreement between GOB and successful bidder **(Outside Sponsor)**	•Outside Sponsor makes Loan Applications to commercial lenders Commercial Lenders perform due diligence •GOB and Outside Sponsor renegotiations for Lenders Requirements •Loan documents prepared •Financial closure	•Carry out Contract Administration functions •Oversee construction by Lenders' Engineer •Conduct satisfactory completion tests •Commercial Operations Date
				Handover phase			
	Inside Sponsor Role						
				Outside Sponsor Role			

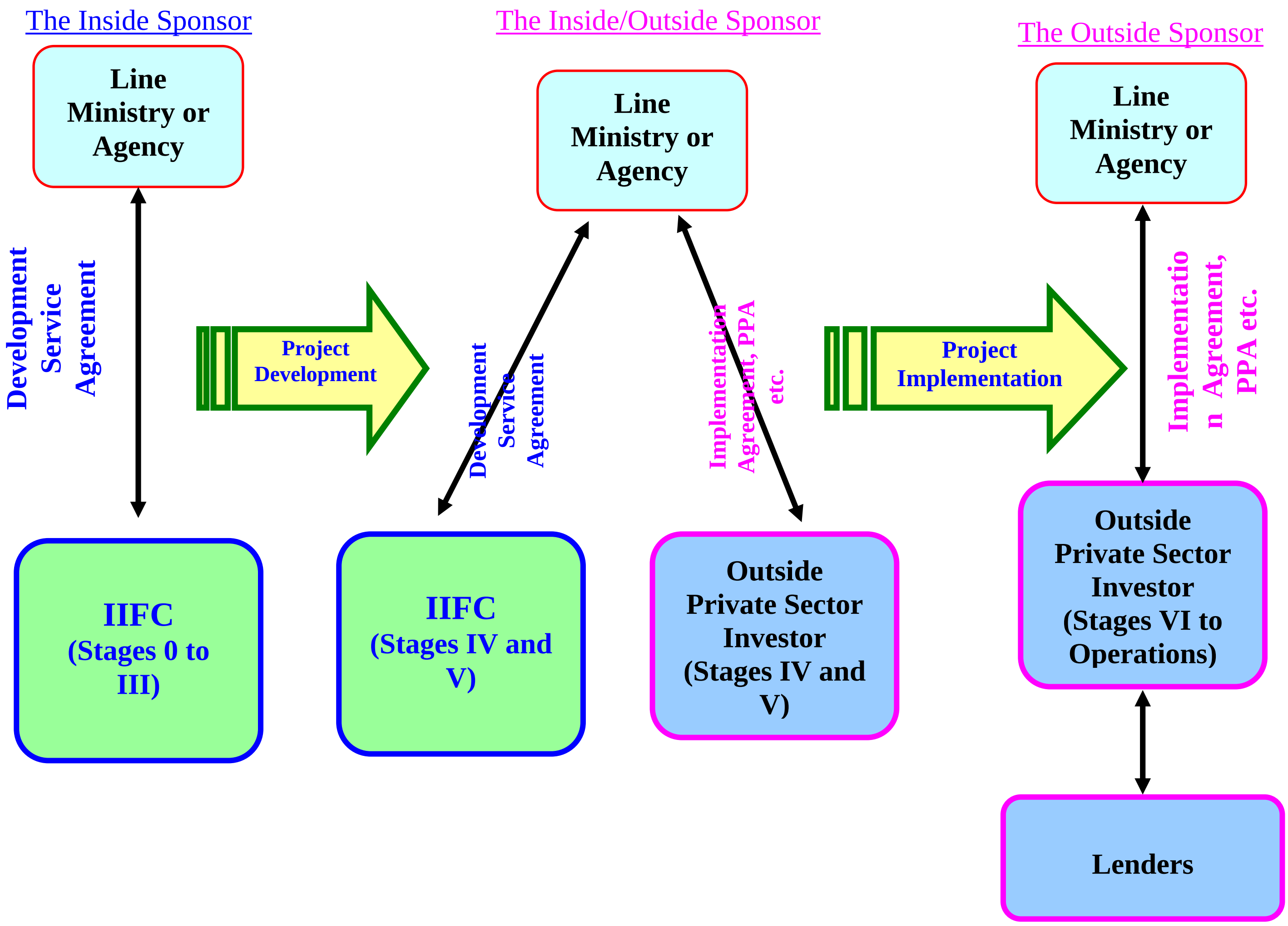
In Stage V, the Outside Sponsor seeks financing from different lenders and this stage ends with financial closure.

In Stage VI, with equity and loan funds in place, the Outside Sponsor engages the construction contractor and physical construction starts. At the end of the stage, the facility goes into commercial operations.

2.3 Change of Project Development From Inside Sponsor to Outside Sponsor

Figure 2 illustrates that the role of the Inside Sponsor is primarily between Stages 0 and IV. This is carried out through an agreement with the Line Ministry of agency. The Inside Sponsor carries out project development between Stages 0 to IV. Within Stages III and IV is the handover phase. From Stage V onwards, the Outside Sponsor takes over, with the execution of agreements with the government, such as the implementation agreement, power purchase agreement etc. In other words, the sponsor role is a continuum from Stage 0 to VI and beyond to operations.

Figure 2: From Inside Sponsor to an Outside Sponsor



2.4 Solicited or Unsolicited Project Sponsors

It should be noted that the concept of the Inside Sponsor is only valid for solicited projects i.e. those projects incorporating Stages II and III. In general, for unsolicited projects, these two stages do not exist. The Outside Sponsor conceives the idea of the project, carries out business development activities in Stage 0 and at the end of this stage, may sign a Letter of Intent or a Memorandum of Understanding with the host government. It then proceeds though feasibility (Stage I), negotiation (Stage IV) and financing (Stage V). While working from Stage 0 to Stage IV, the Outside Sponsor spends a significant amount of development funds, which are at risk in a manner similar to IIFC.

Many governments have discouraged unsolicited proposals, preferring a transparent approach. In a transparent approach, these development funds need to be spent by the Inside Sponsor. In other words, for solicited projects, the Inside Sponsor replaces the role of the Outside Sponsor for unsolicited projects during the initial stages of project development, and faces the same risks. These risks decrease after the Outside Sponsor is identified through competition and takes over the role of developing the further stages of the project after the Handover Phase (Stages III and IV).

Table 1: Who Can be a Sponsor in the Initial Stages (Stages 0 to IV)?

Solicited Projects (Inside Sponsor)	Unsolicited Projects (Outside Sponsor)
Government *line agency,* typically supported by: • Consultants funded by donors	1. Investor/Operator 2. Equipment manufacturer
Government *specialised agency* (such as IIFC), supported by: • Strong in-house skills on commercial and negotiations areas • Rapid support from consultants in specific areas	3. Turnkey contractor 4. Consultant 5. Lender

The table above shows the different organisations that can be the sponsors for the initial stages of project development. It is clear that a specialised agency as the Inside Sponsor will most closely match the skills and perspectives of the Outside Sponsor.

2.5 The Risk Profile for an Inside Sponsor

An Inside Sponsor invests its time, effort and consultant funds at the front-end of project development, primarily between Stages 0 to IV (please see Figures 1 and 3). This period of development is the most risky phase for a private sector infrastructure project. Some of the risks faced by an Inside Sponsor while working in this venture capital region are:

- Project concepts very fluid
- lack of knowledge
- lack of policies
- union pressure
- uncertainty in project design
- uncertainty in costs
- uncertainty in viability
- uncertainty in regulatory regime.

IIFC as an Inside Sponsor seeks to commercialise by working on success fee basis and recover its costs from the winning bidder (completion of Stage IV). In many cases, the projects may stall and not go to Stage IV, in which case, IIFC will lose its money. For example, if the stall rate is two projects to one successful project, then IIFC is exposed to large development risks.

Figure 3 illustrates the risks faced by IIFC while it spends funds to develop the project and create project value. It begins with Stage 0, wherein IIFC carries out its business development activities and eventually signs an agreement (DSA) with the Line Ministry or its agency. This is the most risky stage, as project concepts, viability, investor interest etc are all unknown. Project recognition is vital. A DSA establishes government approval to go forward on the project with private sector financing, instead of public sector financing. The DSA therefore reduces IIFC's risk of not being able to receive government approval. In the next stage, IIFC mobilises consultants for carrying out the feasibility study.

Stage I consultants are easily found, but care should be taken to ensure that the consultants have experience in transactions i.e. Stages II to V. Unless such experience is ensured, consultants may tend to spend a lot of time and effort and not proceed to Stage II, the heart of a transaction. A feasible project at the end of Stage I validates the Inside Sponsor's selection of the project (project recognition) and further reduces the risk. At the same time, many project details are now known and this creates project value, which is in excess of the costs spent by the Inside Sponsor.

Stage II is most important and requires highly experienced Inside Sponsor staff and consultants. Risk allocation between government and the private sector takes place, and concession design, regulatory structure, bidding parameters, fiscal incentives etc. are identified. Most important is the issue of request for proposal (RFP), which denotes the final commitment to proceed with the project as a Private Infrastructure Project. This is a large reduction in Inside Sponsor risk. The chances of a project slowing down are the highest at this stage. Increase in project value is commensurate with the reduction of risk.

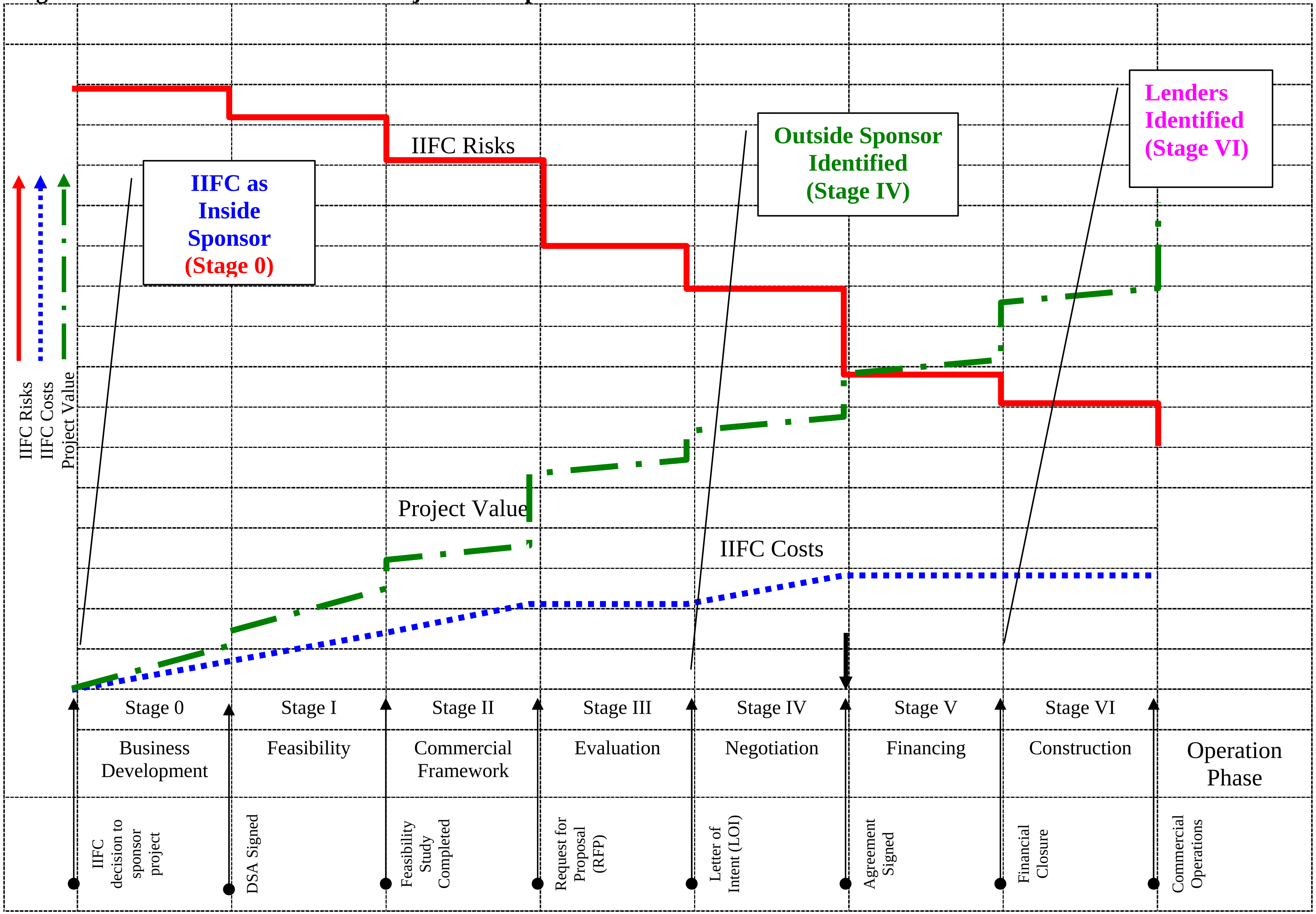
Stage III involves pre-qualification of bidders, submission and evaluation of bids. The Inside Sponsor's risks decrease and project value is increased since it is now known that credible bidders are willing to invest in the project.

Stage IV involves negotiations with the preferred bidder and results in the signing of the concession agreement. The execution of the agreement reflects commitment from the investor and reduces the Inside Sponsor's risks further. The signed agreement has a good value for the Outside Sponsor since it reflects the net present worth of the future cash flows in the project and the right to carry out an infrastructure business in a country. With this signing, the Inside Sponsor's role reduces sharply, as the sponsorship of the project changes hands. Stages III and IV represent the handover phase from the Inside Sponsor to the Outside Sponsor.

In Stage V, the Outside Sponsor seeks loan finance and his risk reduces with financial closure, which is achieved when all lenders are satisfied with the loan documents.

It is clearly evident from the discussions above that IIFC as the Inside Sponsor enters the project at a much earlier timeframe (Stage 0) compared to the Outside Sponsor (Stage IV) and the lenders (Stage VI). IIFC's sponsorship of a project is at a time when risks are extremely high. Only successful management of the various risks will allow the project to move through the various stages towards financial closure and from there to construction and commercial operations.

Figure 3: Risk Profile of Front-end Project Development



3 CHARACTERISTICS OF IIFC AS AN INSIDE SPONSOR

3.1 IIFC Project Portfolio

IIFC carries out projects in a large variety of types and sizes. These are:

1. Large investment projects
2. Restructuring & commercialisation projects
3. Capitalisation projects
4. Policy development projects
5. Management contracts
6. Small investment projects

3.2 Non-Investment Projects

IIFC assists in developing some projects that require no private investment in the near future. PSP in these projects are in the form of management expertise and technical know-how. The government may wish to restructure and commercialise existing public assets and introduce PSP in the form of management contract etc. so that efficiency in the government sector can be improved. Private investment will be made at a later stage after they are restructured to run on a commercial basis.

3.3 Policy Development Work

Considerable efforts of IIFC are put into projects that are non-investment in nature but are important in creating an enabling environment for private sector participation. The policy development services provided by IIFC through Technical Services Agreements (TSAs) are examples of such kind. IIFC activities are therefore not just confined to developing investment projects. It is involved in a much broader activities like assisting government in creating an enabling policy and regulatory environment conducive to private sector participation in the infrastructure sectors.

3.4 IIFC Business Strategies

IIFC is guided by the following key strategies:

- Advise, guide, promote and support PSP, in light of government policies, actions by Ministries and their agencies and market demand. However, *IIFC will not be a party to any agreement or transaction.*
- Be selective in choosing projects to secure maximum impact from limited resources.
- Stress transparency in all activities involving public interest.
- Operate in a commercial manner, securing cost recovery for services where possible.
- Operate through a small highly qualified and professional staff, and supported by swift deployment of consultants - usually within one month.
- Segregate and earmark the private sector projects from public sector projects.

3.5 Policy vs Transaction Focus

One of the key issues arising from IIFC's mandate is the focus – should it be transaction led or policy led? IIFC adopted the strategy to focus on specific transactions or projects and resolve the policy issues contractually on case by case basis, rather than going for wider policy reform. It does not also want to devote limited resources to prepare studies that are not linked to specific transactions. It is however, recognised that in the long term, transactions may be constrained by lack of policies. Therefore, IIFC also pursues policy and sector reforms for PSP to be realised. A good example is the draft Private Sector Infrastructure Guidelines.

3.6 Operating Policy & Procedure

IIFC has gained experience from about just under four years of operation. Based on this, seven elements of policy and procedure have been identified:

- IIFC will respond to requests from government ministries and agencies for assistance. Where assistance can be given, IIFC will enter into a DSA for investment projects and TSA for non-investment projects.

- IIFC will work on success fee basis and seek to recover costs at different stages of project development, primarily from transaction projects.

- Given that IIFC's work may form the basis for negotiations with a private party, IIFC, its consultants and funding agencies will maintain full commercial confidentiality of the concerned projects.

- IIFC's impact can be greatest if it is involved in the commercialisation stages of project development (i.e. from Stage II onwards), with some input into Stage I. IIFC's policy is thus to enter after the completion of feasibility studies. A number of government departments and agencies supported by bilateral and multilateral institutions, presently carry out such studies, and IIFC's niche will be in the later stages of project development.

- IIFC will focus on stranded or under-utilized assets of the government. Value addition of such infrastructure is likely to have large benefits to the economy.

- Restructuring and commercialisation of state-owned-enterprises is also an area to be pursued by IIFC. It will assist these enterprises in their long-term viability through private sector investment, management and participation.

Private sector infrastructure projects have low visibility in the national approval and financing processes. IIFC will attempt to raise the status of private sector projects through segregating public sector and private sector infrastructure projects. It will propose through appropriate policies and guidelines that such segregated projects should be listed separately.

3.7 Rapid Consultant Support

The consultants presently being used by IIFC are funded by donors. DFID has appointed KPMG and CIDA has appointed CBIC as the consultants. The two consortiums of consultants provide support for carrying out the investment and non-investment projects, business development work, promotional activities, institutional and capacity building. IIFC has call-down arrangements with KPMG and CBIC for rapid mobilisation of consultants from the date of engagement by a line Ministry or Agency, through either a DSA or a TSA. Rapid deployment of consultants is one of the greatest strengths of IIFC, which has been much appreciated by Line Ministries and agencies.

3.8 IIFC as a Trusted Partner of Line Ministries/agencies

One of the most critical needs is for the Inside Sponsor to gain the trust of the Line Ministry and its agencies. As a trusted partner and advisor to a government agency and with growing relationship, the execution of DSAs between the Line Ministry/agency and IIFC becomes easier. The relationship is improved rapidly, if the following areas are kept in mind:

- The Inside Sponsor needs to have genuine intention of assisting the government ministry or its agency.
- There should be rapid mobilization (one month) of high quality consultants, experienced in Stages II to V.
- There should be a good balance of in-house skills and outside consultants.
- Charging the ministry or its agency should be avoided, opting instead for charging the beneficiary of the process, i.e. the Outside Sponsor.
- The Inside Sponsor should have knowledge and experience of project development and *understand fully, the processes behind Stages 0 to VI.*

3.9 Provider versus Procurer Model

The core function of IIFC is to provide advisory services to client ministry or its agencies. IIFC would act as the provider of services (the Provider Model), to its client ministries and its agencies, rather than act as the procurer of donor consultant services (the Procurer Model). This is consistent with its mandate under its Memorandum of Association approved by the government. The Provider Model is more proactive and with commercial focus and hence sustainable. Being proactive, there needs to be a keen sense for developing its business in a proactive manner. This model also implies that it uses consultants, where needed, to perform specialist functions. This is in addition to its in-house skills, which it will always seek to develop and use, during the provision of its services to its clients. Using consultants effectively and delivery of services requires good project management skills on the classic parameters of – on time, on budget and as specified.

3.10 Commercialisation and Development of In-house Skills

At present, IIFC is providing services to clients, mainly through donor-funded consultancy support. IIFC in-house staff provides approximately 30% of the advisory services, while the balance 70% is received from consultants. As a long-term development strategy for sustainable operations and part of its commercialisation process, IIFC needs to increase and develop in-house expertise, to the extent that it can provide a larger percentage of the services. The policy of IIFC is to commercialise as soon as possible. The commercialisation process will be aided by developing in-house generalised experts and hiring from outside, specialised experts, as required. The services of IIFC would then be revenue earning on a project development basis and key IIFC staff saleable to clients as experts.

4 COMMERCIALISING AN INSIDE SPONSOR

Commercialisation of an Inside Sponsor will provide to it, the direction and approach, very much essential for its success. It is important to remember however, that, in order not to enter into conflicts of interest, an Inside Sponsor should not have an equity interest in the project that it is developing. The revenues and risks for commercialising an Inside Sponsor is classified and described in Table 2. The financing sources for commercialising an Inside Sponsor, can broadly be categorised into three types as described in the sections below.

4.1 Budget Based

A budget-based source means a source like the financing which IIFC presently receives through PSIDP, where IDA and GOB provides funds to IIFC as an institution. Such type of financing puts a minimum risk to IIFC in selecting projects or realising private investment.

4.2 Consultancy Fee Based

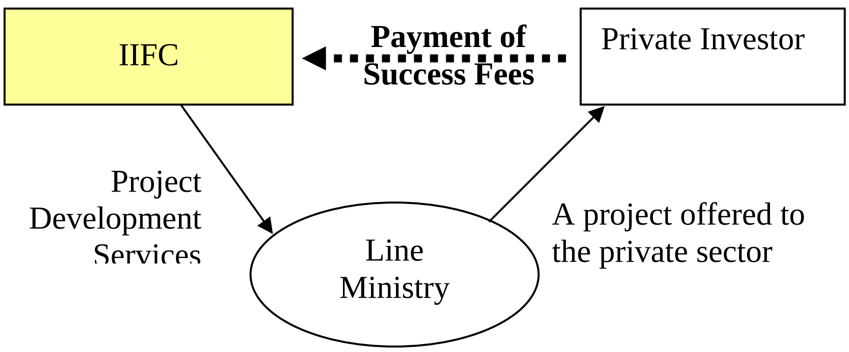
IIFC can earn fees as consultancy-charges from the Ministries for developing a particular project for offering to the private sector. IIFC will receive fees at a pre-fixed rate per man-hour spent. It does not impose risks to IIFC of the project not being successful. However, ministries will be less willing (including time delays to obtain the TA funds) to receive IIFC's services if they have to pay directly.

These do not pose a success risk on IIFC, for moving a project through its various stages and bringing investment. Once the recommendations are provided, IIFC receives the fee, irrespective of whether the project is implemented or not. However, IIFC like any other consultant, is exposed to the risk of having to obtain the work assignment.

4.3 Success Fee Based

This is the most exciting source of cost recovery for IIFC, as it allows charging a fee for IIFC services from the beneficiary of IIFC services i.e. the investor. As IIFC is creating a business for a private investor by developing a project, private investors can be charged *project development fees* for the project development services provided by IIFC. Figure 4 shows the mechanism for the Success Fee Based financing for an Inside Sponsor.

Figure 4: The Success Fees Model



However, this payment depends upon successful private investment. It imposes a large risk to IIFC, because unless the project can be developed to attract the private sector, there will be no private investor available to charge. The risks are illustrated graphically in Figure 3. It needs very good project recognition skills, as it is necessary in Stage 0 to take a view that the project will be interesting to investors in Stage 3 (which may take 2 years to achieve). If the project is not successful, IIFC loses its investment in time and money.

The success fees can be pre-specified at different stages in the Request for Proposal (RFP) process (e.g. upon being short-listed, issue of Letter of Intent, signing Security Package etc).

TABLE 2: REVENUES AND RISKS IN INSIDE SPONSOR FINANCING MODELS

Models / Parameters	Budget Based	Consultancy Fee Based	Success Fee Based		
			Public Source Fee		Private Source Fee (Developer)
			Government	Donor	
Scenario Descriptions	The present PSIDP project is Budget Based. IIFC as an Inside Sponsor has two types of budgets for 3 years initially: For establishment from IDA/Govt. and consultants from donors	Inside Sponsor is on a normal client-consultant relationship and revenue is on a monthly invoicing basis.	Success Fee Based arises when fees are payable to Inside Sponsor based upon the success of the project i.e. signing of an investor. The milestones for payment could be issuance of Letter of Intent, signing of Security Package or others. The Success Fees can be payable from public sources, whether from donor or from government budget. Success Fees can also be paid from the beneficiaries of the Inside Sponsor's project development efforts i.e. private investor or developer		
Financing Set-up	A budget is set up, as in a government department	A normal client-consultant financing	A budget is set up, which is replenished through successful projects	Govt/donor mechanism with payments at defined milestones	Payment by the successful investor, as the beneficiary of the Inside Sponsor's project development effort
Demand of Inside Sponsor service from Ministries	Demand for Inside Sponsor services are very high	Extremely low demand as ministries do not have funds	Very good demand	Very good demand	Very good demand
Revenue certainty for Inside Sponsor	Certain for 2 to 3 years	Normal consultant's risk for being engaged	Fairly certain, provided fund is replenished by successes	Fairly certain, provided milestones are met	Highly uncertain. No consultant works this way, but developers do.
Risks to Inside Sponsor	No risk to Inside Sponsor	No risk once engaged. However, Inside Sponsor faces risk of insufficient engagement.	Continuation of fee tied to success	Fee tied to defined milestones	Very high risk as Inside Sponsor fee tied to success. Inside Sponsor faces all of the developer's risks.
Concern for negotiating Inside Sponsor fee amount	No concern as such negotiations are not necessary	Some concern	No concern as fee based on approved charge-out rates	No concern as fee based on approved charge-out rates	Each ministry or its agency will need to carry out such negotiations and concern exists for the basis of negotiations.
Project recognition Skills	*Very poor project recognition skills due to revenues not dependent upon success. With donor funded consultants, who are not under direct control of Inside Sponsor, this problem is compounded*	*Project Recognition Skills are client driven and generally poor (consultant mode)*	*Very good (continued revenue depends upon replenishment of fund)*	*Good, otherwise project will not move through the milestones, leading to stoppage of revenues.*	*Extremely good project recognition skills (developer mode). Success Fee depends on avoidance of project stall or other forms of failure.*
Applications	Have the widest applications. Applicable for: • policy development work • poverty alleviation work • reforms related work • Capacity building • Large investment projects • Small investment projects	Needed for: • policy development work • poverty alleviation work • reforms related work	Applicable for large investment projects	Applicable for small and large investment projects	Applicable for large investment projects only. However, an Inside Sponsor will tend to avoid large complex projects. No cost recovery is possible in policy development work and poverty alleviation projects.

4.4 Changes Towards Commercialisation

At present, IIFC is financed 100% on Budget Based. As shown in Table 3, the target towards commercialisation is to achieve a mix of financing with Budget Based being 20%,

Table 3: Financing Changes Towards Commercialisation

Types of Financing	IIFC at Present	IIFC Target
Budget Based	100%	20%
Consultancy Fee Based	0%	50%
Success Fee Based	0%	30%

Consultancy Fee being 50% and Success Fee being 30%.

5 CONCLUSIONS

The following conclusions may be drawn:

1. The concept of Inside Sponsors needs to be discussed and understood more thoroughly. The discussions should include Outside Sponsors, who are the beneficiaries of the effort and need to provide their support to the concept.
2. Project recognition skills are extremely important for an Inside Sponsor and this can be ensured through a commercial focus. Success will depend on the ability to manage risks from Stage 0 to Stage IV.
3. The concept, with some revisions based on the lessons learnt, may be of assistance to countries, which have difficulty in increasing private sector participation in infrastructure.

Author’s Note: The models, processes and views expressed in this paper are those of the author and does not necessarily represent the views of the Government of the People’s Republic of Bangladesh, IIFC or any of its donors and stakeholders.