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Firm-level conditions to engage in public-private partnerships: What can we learn?

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ABSTRACT

This research examines the firm-level conditions of Portuguese listed companies to be engaged in Public Private Partnerships - Service Concessions Arrangements (PPP/SCA). Based on accounting standards and other legislation regarding PPP/SCAs, a set of firm's characteristics was tested in order to find determinants for that engagement. Through empirical evidence it is suggested that larger firms and relative higher leveraged firms attract more PPP/SCA projects. The results also imply that when the most important segment report is coincident with the primary line of business industry, firms have more probability of being engaged with a PPP/SCA. Findings also show that profitability and financing costs (as a proxy for risk) are not robust determinant for attract a PPP/SCA. This paper adds to the scarce (but in a growing phase) literature on the financial reporting of service concessions arrangements, contributing to a better understanding of the extent and conditions behind PPP/SCA.

1. Introduction

The Public Private Partnerships[1] (PPP) model represents a measure that sovereign states can use to respond to their financial limitations and to provide public services. Several governments have

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[1] Public-Private Partnerships, also known as "PPPs", are "agreements between the government and one or more private partners (which may include operators and financers) according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners

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begun to encourage the private sector to take part in the "development, financing, operating and maintenance" of public infrastructure for public services; as an incentive, they have created concession contractual service arrangements. These arrangements can address infrastructure construction or the maintenance, management or upgrade of public services or infrastructure. Active programmes are ongoing in France, Spain, Portugal, Germany, Netherlands, Canada, and Australia and have been adopted in many countries as part of a wider privatisation and funding agenda. This phenomenon is driven by an increased need for accountability and efficiency in public spending (Demirag & Khadaroo, 2011a).

Due to the governments' increasing financial limitations and recent economic and financial crisis, these deals offer a valid alternative to share financial risk with private partners (e.g., see Demirag & Khadaroo, 2011b). Additionally, they help to remove obligations from the government in order to ensure that governments can focus their resources on other and more relevant public responsibilities.

In recent years, governments have been subject to increased pressure to invest in infrastructure, enabling the national development. PPP/SCAs are an important tool to achieve this goal globally, playing an increasingly large role in the importance and impact of national and local policies of countries. Portugal is no exception; the recent crisis and the intervention of *Troika* (European Commission, European Central Bank and International Monetary Fund) made the State's expenditures a target for public and media scrutiny, including those related to PPPs.

Some literature suggests that PPPs do indeed have the potential to be beneficial for services, particularly when there is sufficient past experience and when the uncertainty is limited (Iossa & Martimort, 2011). One of the most precise arguments favouring PPP/SCAs is the transfer of risk to the private sector within a structure, in which financiers put their own capital at risk. However, certain authors call attention to whether it is truly beneficial for the State to shed risk to the private sector. For instance, Froud (2003) does not argue that the private sector can deliver a range of lower cost services; instead, he questions whether the State should assume the role of managing those specific risks. Prior works on risk in PPP/SCAs have investigated "what" risks were allocated and to "whom" (e.g., Li, Akintoye, Edwards, & Hardcastle, 2005; Quiggin (2005); Shen, Platten, & Deng, 2006; Singh & Kalidindi, 2006), "how" and "why" risks were diffused by their financiers (Demirag, Khadaroo, Stapleton, & Stevenson, 2012), and how the goals of certain contracts appear to be changing in favour of private partners at the expense of taxpayers (Burke & Demirag, 2013). While studies of risk have been performed, there has been considerable disagreement on how to account for PPP/SCAs in the balance sheets of the public and private sectors. The framework of Broadbent and Laughlin (2005) is a good example of this controversy between the State and the accounting profession in the United Kingdom, arguing that the relationship between the public and private sectors, with respect to setting an accounting standard, may yet require debate.

This increasing impact has not passed unnoticed by the accounting community. The complex relationship between the public and private sectors has created the need for new accounting interpretations and guidelines. The International Accounting Standards Board (IASB) had been working on this issue and, in recent years, had created international guidelines regarding accounting for concessions and similar types of contracts; the issue of IFRIC 12–Service Concessions Arrangements (henceforth known as IFRIC 12) brought new attention to this topic (IASB, 2006a). Since 2008, this interpretation, as well as all the core standards issued by IASB, is mandatory for all private sector companies that are listed on a European Union stock exchange.

Despite the existence of public and media attention around different types of PPPs, there is scarce information regarding the application of IFRIC12 and its impact on private sector companies. Several important research studies have been exploring relationships between several concepts underlying PPP/SCAs (e.g., accountability and value for money) and their impact on public sector governmental initiatives (Demirag & Khadaroo, 2011a). Most prior works have explored PPPs from the perspective of the public sector purchaser, only few exceptions include research studies on risk from the perspective

and in which the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners" (Burger and Bergvall, 2008:9). This model was born due to recognition by the States that, despite their responsibilities and need to intervene in sectors considered part of the public interest, they occasionally could not intervene alone due to numerous factors, namely budget constraints, investment size or lacking the specific expertise possessed by certain private companies.