



Private-investment opportunities in **public transport**

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Public-private partnerships represent a significant opportunity for private investors—but pose worrisome risks as well.

Opportunities for the private sector to invest in public-transportation infrastructure through public-private partnerships are likely to be worth more than \$330 billion from 2005 to 2010, accelerating a growth trend that began in the mid-1990s.¹ But in some countries weak political commitment, a lack of appropriate regulatory safeguards, and poor project governance pose worrisome risks for investors.

The pipeline of public-transport projects requiring private capital, as McKinsey research shows, includes everything from new road and bridge construction in Germany to the expansion of ports in Eastern Europe and the extension of urban transit systems across Asia. While the planned projects cover all continents and modes of transportation, the biggest investment opportunities are in the

EXHIBIT I

The pipeline

Projected volume of planned investments in public-transportation infrastructure for selected countries, 2005–2010¹



¹Global total extrapolated from country data weighted by GDP; for Australia, Brazil, China, France, Germany, India, Italy, Japan, Portugal, Russia, South Korea, Thailand, United Kingdom, and United States; breakdown by transportation mode not available for Australia and Portugal.

²Estimated value of required private investment in publicly owned infrastructure.

Source: Dealogic; McKinsey analysis

United States, China, the United Kingdom, and South Korea. Greenfield road and rail projects account for the lion's share of planned projects (Exhibit 1).

Exhibit 2 shows the breakdown by region and transportation mode.² Globally, rail will account for 48 percent of the total value of projects, roads for 44 percent, seaports for 6 percent, and airports for 2 percent. Rail recently emerged as the largest mode by value: though less numerous than roads, rail projects tend to be more expensive and far more complex. The fact that seaports and airports are largely privatized explains why the opportunities in those public markets are small.³ Moreover, the fast-growing economies of Asia are surpassing the more mature Western European markets.

Governments around the world typically have three reasons for embracing private-sector infrastructure investment: to serve as a catalyst for reforming public services, to save money, and to create additional financing capacity outside public budgets. Banks, pension funds, and private-equity funds, for their part, are increasingly attracted by

the combination of growth, predictable cash flows, and income streams uncorrelated with public-equity markets. The value of funds dedicated to infrastructure jumped from \$5 billion in 2004 to approximately \$45 billion in 2007. At least ten such vehicles were launched in 2006, and more than a dozen large ones are expected in 2007. Construction companies and infrastructure operators, such as Ferrovial and Skanska, are also intensifying their participation in these investments.

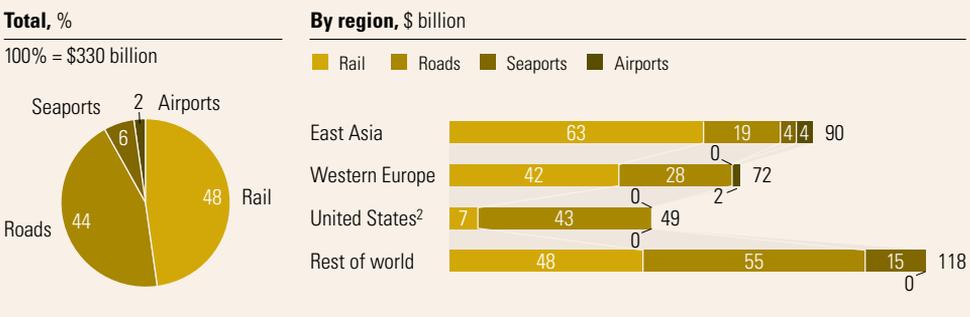
Investors with little experience developing and operating transportation assets in unknown environments should be particularly cautious. Recent high-profile failures, characterized by protracted and damaging litigation, in parts of Eastern Europe underline the challenges of successful execution. Indeed, even as the demand for infrastructure investments and the supply of capital explode, the rate of growth in the cumulative value of successfully completed projects has slowed from 15 percent a year (1998–2001) to just 5 percent (2003–06).

The most stable and attractive opportunities lie in markets that have both a large

EXHIBIT 2

The regional landscape

Projected volume of planned investments in public-transport infrastructure by region, 2005–2010, \$ billion¹



¹Based on project start date; global total extrapolated from country data weighted by GDP; for Australia, Brazil, China, France, Germany, India, Italy, Japan, Portugal, Russia, South Korea, Thailand, United Kingdom, and United States.

²Figures do not sum to total, because of rounding.

Source: Dealogic; McKinsey analysis

pipeline of viable investments and a degree of what we call “PPP readiness.” The analysis of a country’s readiness for these projects was based on three key factors: the extent of a government’s commitment to public-private partnerships (clarity of vision, the project pipeline’s robustness and transparency, and stakeholder perceptions), the effectiveness of their governance (legal and institutional frameworks, clear parameters for choosing projects, and effective and capable government institutions), and a track record in execution (business plans that identify the main risks, strong tender processes, and regularly used feedback mechanisms). While competitive intensity in mature markets is likely to be higher, resulting in potentially depressed returns, we do not yet see signs of pricing pressure for greenfield projects, which make up the bulk of the public-private opportunity.

the United Kingdom, and the United States represent the most structurally attractive areas. China, Germany, and India are among the markets we classify as emerging opportunities, which can be quite risky. (In China, for instance, we found little evidence that government agencies have created transparent, predictable mechanisms for structuring and awarding public-private partnerships.) Finally, investors should proceed with particular caution in Brazil, Russia, and Thailand, where—despite a growing project pipeline—immature market conditions pose significant risk across several dimensions of PPP readiness.

In this rapidly evolving context, investors in public-private partnerships must be able to spot opportunities to create value where others don’t. Superior deal sourcing is a critical prerequisite for avoiding “over-fished ponds.” In looking for opportunities, investors must decide if they have the appetite and skills to manage and mitigate a variety of potential new risks (such as

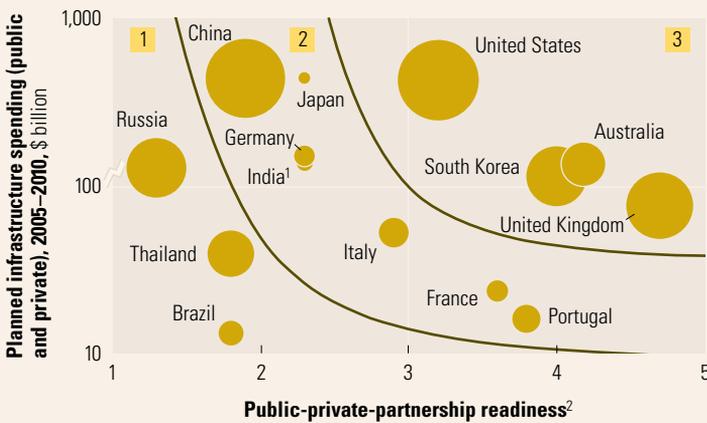
Exhibit 3 summarizes the results. Our analysis reveals that Australia, South Korea,

EXHIBIT 3

The readiness is all

Country attractiveness

- 1 'Proceed with caution'
- 2 'Emerging opportunities'
- 3 'Hot spots'



Size of bubble = amount of planned private investment
 \$50 billion
 \$10 billion

¹Recent plans indicate even larger opportunities in the future.

²Average of score on scale of 1 to 5, where 1 equals least ready and 5 equals most ready; measured across 9 dimensions, eg, is there a robust legal and institutional framework in place?

construction and market risks) effectively. Newcomers to infrastructure investment should stick to familiar geographies and transport modes before expanding and diversifying. They should certainly avoid crowded bidding wars such as the one for the privatization of the Port of Hamburg, which has attracted interest from more than 100 parties.

Skilled due diligence and deal execution, as well as a basic knowledge of infrastructure assets, are necessary but not enough to create long-term value. Winners will sustain their positions only by building and honing a distinctive knowledge of asset development and operations, not just financial engineering. Best-in-class road operators, for example, manage their assets up to 30 percent more cost effectively than their peers do by optimizing the cost of capital repairs, routine maintenance, toll collection, and traffic management. Still, while operational cost advantages translate into a better position at the bidding table, they are notoriously difficult to sustain. That in turn puts a premium on hiring and retaining world-class talent and managing knowledge efficiently within the organization.

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¹ The figure of \$330 billion represents the estimated value of the currently planned private investment from 2005 to 2010 in airport, rail, road, and seaport infrastructure around the world.

² Our analysis involved a detailed study of markets in Australia, Brazil, China, France, Germany, India, Italy, Japan, Portugal, Russia, South Korea, Thailand, the United Kingdom, and the United States. Global totals were then extrapolated from this sample.

³ Our estimates include only investment opportunities in publicly owned infrastructure; privatization has created adjacent pools of privately owned infrastructure assets not considered here.