



PRESENTATION

## ZPCG institutional strengthening programme

SEETO Railway Working Group  
Podgorica, 14/11/2012

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- Public Service Obligation (PSO) methodology
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### The assignment is covenanted by EBRD's loan to ZPCG and supports institutional strengthening of ZPCG

Background | Diagnostic | Business plan | PSO methodology | PSO contract

- EBRD provided a sovereign loan to the Republic of Montenegro. The loan beneficiary is Željeznički Prevoz Crne Gore ("ZPCG"), the national railway operator company. The purpose of the loan is to procure new EMUs for the ZPCG's fleet.
- The loan includes two institutional development covenants for the railway sector in Montenegro:
  - Requirement for ZPCG to improve its operational and financial performance through further restructuring
  - Requirement for ZPCG and Ministry of Transport and Maritime to transition to the new form of contractual relationship, a form of a Public Service Obligation (PSO) contract.
- This consulting assignment is designed to assist with the institutional restructuring of the railway sector in Montenegro and includes four key deliverables:
  - 5-year rolling Business Plan (2012 – 2016)
  - Guidance to ZPCG on Business Planning update
  - Public Service Obligation (PSO) Methodology
  - Public Service Obligation (PSO) contract

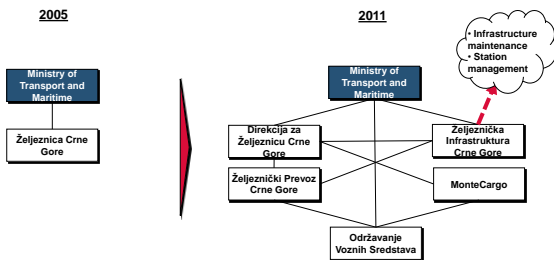
### Practical proposals for the programme of improvements were developed in close collaboratively with the ZPCG experts

Background | Diagnostic | Business plan | PSO methodology | PSO contract

PHASE	Preliminary Work	Strategy Formulation	Preparation of Implementation Plans
ACTIVITIES	<ul style="list-style-type: none"> <li>▶ Data collection</li> <li>▶ Institutional review of the rail sector in Montenegro</li> <li>▶ Commence ZPCG corporate review and gap analysis</li> </ul>	<ul style="list-style-type: none"> <li>▶ ZPCG performance analysis</li> <li>▶ Identification of areas for improvement (at institutional and ZPCG corporate levels)</li> <li>▶ Specific Governmental aspirations</li> <li>▶ Development of Corporate strategy for ZPCG (objectives, work volumes, resources, corporate governance) and specific performance targets</li> </ul>	<ul style="list-style-type: none"> <li>▶ Update of PSO Methodology and Business Plan based on Stakeholders' feedback</li> <li>▶ Preparation of PSO Contract</li> <li>▶ Preparation of Business Plan Update Report</li> </ul>
OUTPUT	<ul style="list-style-type: none"> <li>▶ ZPCG kick-off meeting</li> <li>▶ ZPCG and stakeholder meetings</li> <li>Reports:                             <ul style="list-style-type: none"> <li>▶ Inception Report</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ ZPCG and stakeholder meetings</li> <li>Workshops:                             <ul style="list-style-type: none"> <li>▶ PSO Methodology I</li> <li>▶ Business Plan I</li> </ul> </li> <li>Reports:                             <ul style="list-style-type: none"> <li>▶ Draft PSO Methodology Report</li> <li>▶ Draft Business Plan 2012 – 2016 (including details of proposed arrangements for EMS and OHS)</li> <li>▶ Quarterly Reports</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ ZPCG and stakeholder meetings</li> <li>Workshops:                             <ul style="list-style-type: none"> <li>▶ PSO Methodology II, Business Plan II, PSO Contract I and II, Business Plan Update Guidance</li> </ul> </li> <li>Reports:                             <ul style="list-style-type: none"> <li>▶ Final PSO Methodology Report, Final Business Plan 2012 – 2016, Draft and Final PSO Contract, Business Plan Update Guidance</li> <li>▶ Quarterly Reports</li> </ul> </li> </ul>
DURATION	Month 1	Months 2 - 5	Months 6 - 12

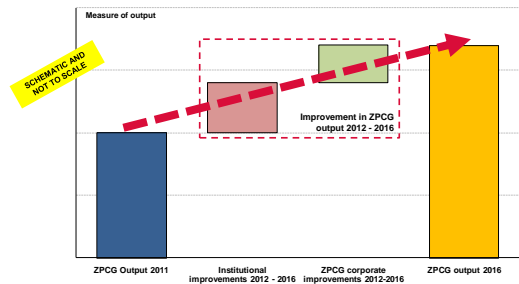
### Montenegrin rail sector has undergone significant transformation with plans in place for further "unbundling" of the railway activities

Background | Diagnostic | Business plan | PSO methodology | PSO contract

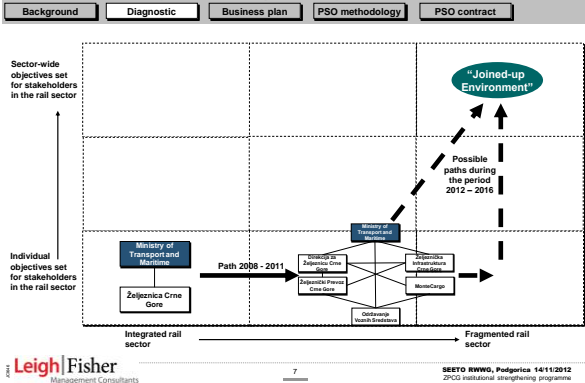


### Success of ZPCG institutional strengthening programme required improvements at two levels - institutional and corporate

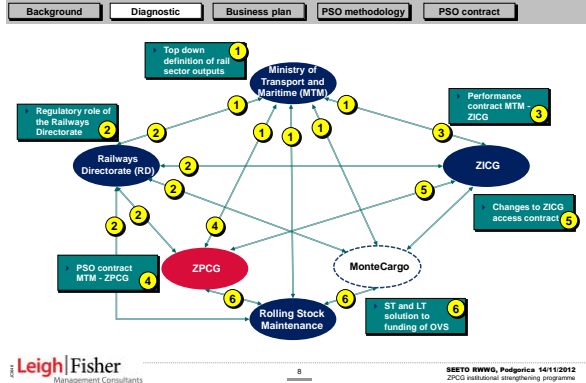
Background | Diagnostic | Business plan | PSO methodology | PSO contract



The assignment supported identification and articulation of the most effective path to the "joined-up rail sector environment"



The action plan involved introduction of clear contractual frameworks as vehicles to achieve the Ministry's goals and outputs



Considerable difficulties made ZPCGG operation of rail passenger service in its current form unsustainable beyond the short term

Background	Diagnostic	Business plan	PSO methodology	PSO contract
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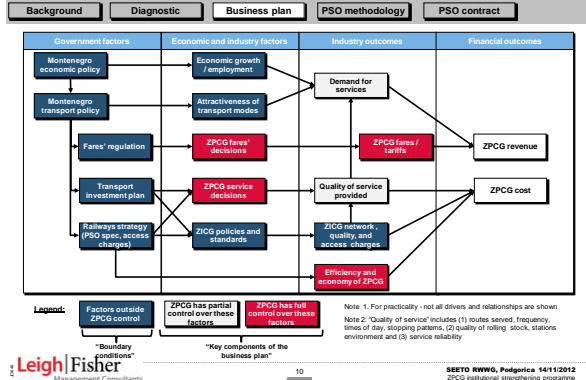
**Constraints to ZPCG Operations**

- Insufficient amount of available rolling stock, and EMUs in particular, for the local services
- The serious state of disrepair of its aging fleet of EMUs
- Inability to control the quality of rolling stock maintenance due to lack of true competition amongst suppliers in the region
- Major distortions to the passenger services timetable being caused by the simultaneous execution of a number of infrastructure upgrade and modernisation works:
  - Low line speeds on local lines
  - Low line speeds on Serbian Railways' infrastructure impact international services
  - Delays and cancellations due to the execution of a major programme of network upgrade works during the day

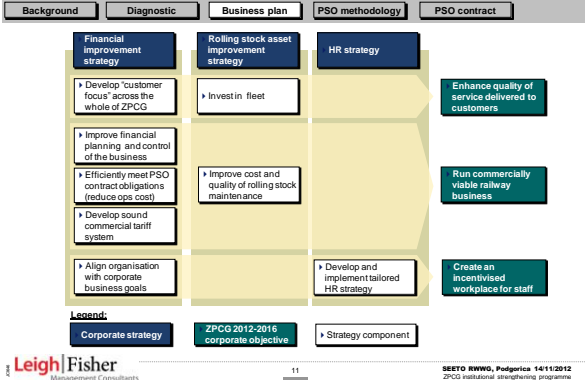
**Preliminary assessment**

- In its current condition, Montenegro's domestic rail passenger service is not sustainable beyond the short term:
  - The quality of service being provided has declined substantially in recent years
  - Passenger levels have fallen significantly (by 70% between 1989 and 2009)
  - Already low cost recovery levels have been declining further
  - Revenue from local and international services stand at 10% and 30% of total revenue, respectively.

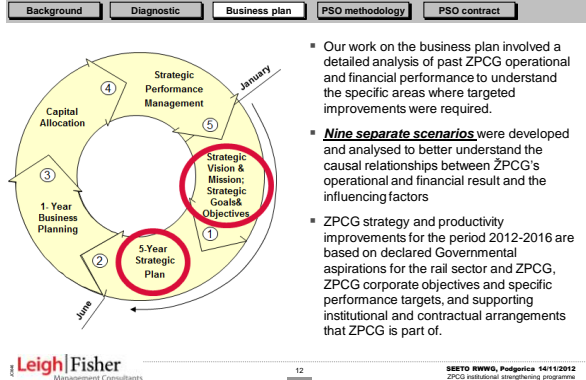
In spite of difficulties, ZPCG remains responsible for a number of key decisions that impact its operational and financial performance



Corporate improvement strategy was developed in support of three key strategic goals for ZPCG



The five year rolling business plan was developed as the delivery vehicle for ZPCG corporate strategy



- Our work on the business plan involved a detailed analysis of past ZPCG operational and financial performance to understand the specific areas where targeted improvements were required.
- Nine separate scenarios were developed and analysed to better understand the causal relationships between ZPCG's operational and financial result and the influencing factors
- ZPCG strategy and productivity improvements for the period 2012-2016 are based on declared Governmental aspirations for the rail sector and ZPCG, ZPCG corporate objectives and specific performance targets, and supporting institutional and contractual arrangements that ZPCG is part of.

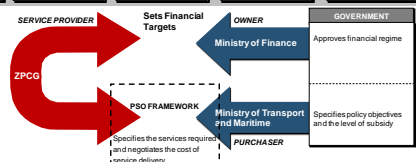
**The adopted scenario is selected as the most attractive financial and practical option for ŽPCG business for the period 2012-2016**

Background Diagnostic Business plan **PSO methodology** PSO contract

- This chosen option secures the optimum balance of (a) revenue and cost for ZPCG and (b) volume growth within the constraint of PSO funding for the Government.
- Under the adopted scenario ŽPCG generates a 95% increase in train-km against the forecasted value for 2012.
- For the given level of operation, the adopted scenario requires relatively the lowest PSO payment in 2016 and the lowest NPV of PSO payments for the period 2013-2016.
- The business plan also includes supporting operational and financial projections and implications (organisation structure, headcount, efficiency targets, and related investment plan).

**Introduction of a PSO framework offers considerable advantages to the Ministry and ZPCG**

Background Diagnostic Business plan **PSO methodology** PSO contract



- | Advantages of PSO Framework to SOCs   | Advantages of PSO Framework to Government  |
|---|--|
| <ul style="list-style-type: none"> <li>▪ The scope of PSO activities undertaken by a SOC is limited to an agreed level and the Government is not able to increase the scope of these services without acknowledging and funding the cost of additional service requirements</li> <li>▪ There is a clear distinction between the commercial and non commercial activities undertaken by SOCs</li> <li>▪ The medium/long term funding of SOC activities is secured by the contract arrangements with government</li> <li>▪ Management is provided with clear policy objectives</li> </ul> | <ul style="list-style-type: none"> <li>▪ In setting up PSOs, the government reviews its activities in the context its broader policy objectives</li> <li>▪ Government departments are provided with much greater clarity as to the social objectives being pursued and the corresponding financial support</li> <li>▪ By limiting funding to specifically coated PSO activities within a SOC, the government lowers/removes the risk of indirectly funding loss-making non-PSO activities</li> <li>▪ By developing the purchaser provider model, government can monitor the success of a particular delivery mechanism in achieving its policy objectives</li> </ul> |

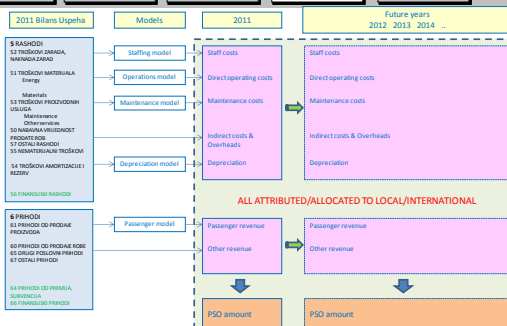
**The PSO Methodology and contract provide the basis for the new commercial relationship between ZPCG and the State**

Background Diagnostic Business plan **PSO methodology** PSO contract

- **The PSO methodology addressed four key PSO aspects:**
  - Design considerations (legal, economic and financial considerations, lessons learned from PSO contracts from the EU and comparable environments).
  - Components of PSO methodology
  - PSO procedure (budget preparation, delivery of service, monitoring and audit of contract delivery in ZPCG and within the Montenegrin Government)
  - PSO Contract outline (legal framework, PSO contract components).
- **In addition, the methodology needed to cover the following:**
  - Ownership of new rolling stock, procured from the proceeds of the EBRD loan – whether it should be owned by the Montenegrin State or ZPCG, along with a recommendation for the depreciation methodology to be used.
  - Length of the PSO and applicability of international lessons learned in respect of realising efficiencies to ZPCG.
  - Target levels of efficiency for the PSO contract.
  - Interrelationship between the Access Contract and PSO Contract in lieu of the requirement for State's funding of a publicly owned ZICG.

**The proposed PSO methodology enables ZPCG to develop a transparent and auditable PSO budget the Ministry's approval**

Background Diagnostic Business plan **PSO methodology** PSO contract



**The final PSO Contract is the embodiment of the principles defined in the PSO methodology and the business outlook**

Background Diagnostic Business plan **PSO methodology** **PSO contract**

PSO Contract	
<b>A. Preamble</b>	
<b>B. Main Body of Contract</b>	
<b>Preliminaries</b>	
<b>Provisions</b>	Service provision Financial provisions Term and termination General provisions
<b>Schedules</b>	PSO Contract timetable Performance Other obligations Contract administration Financial model

- The Montenegrin railway reform programme focussed on efficiency and performance and introduced rail passenger transport as a separate business on the Montenegrin railway network.
- ŽPCG provides unfunded loss-making railway passenger services which needed to be addressed using a Public Service Obligation arrangement.
- PSOs are activities undertaken at Government direction which a commercially-focussed business would not perform under the same terms and conditions.
- The PSO contract was drafted to term sheet level in both Montenegrin and English.
- ZPCG developed the final PSO contract in Montenegrin legal language.

**Discussion**