Improving Client Internal Capability to Monitor Public-Private Partnerships Projects: A Review

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ABSTRACT

Public-Private Partnerships (PPP) or Private Finance Initiatives (PFI) are increasingly becoming very popular with governments across the globe for the provision of public infrastructure and services. When contracted, the public sector client believing the private sector will act in accordance with ‘bounded rationality’, ignores the constant monitoring and review process which is an integral part of any project. However, the failures of some of these partnerships and the social and economic costs incurred due to laxity in monitoring reminds us of the need to develop the permanent bureaucratic machinery of government, who share the government’s unique objectives of end-users satisfaction rather than shareholders’, to perform the monitoring of these projects. Though the public sector has been delivering projects for decades, the complexities associated with the PFI strategy has opened up new challenges for its staff. Most failures and moral hazards are only discovered after scandals evoke investigations like the case of Enron or when public criticisms force the government to reverse their decision as in the case of the Skye toll bridge by which time a lot of damage would have be done. Literature has shown that when employees are trained and engaged in organisational decisions and policy planning they make policy executions easier. Therefore, considering the Theoretical ideology behind the PFI of the asset being returned to the Public sector at the end of the concession, it becomes pertinent for proper training of the public sector staff. Public sector officials, if adequately trained and motivated can perform the tasks being contracted out to private consultants thereby re-affirming government’s commitment to its Value for Money (VFM) proposition. Though the public sector staff strength has been depleted due to the adoption of New Public Management (NPM), however the remaining qualified staff can be pooled to create an ‘incubator’ from which a formidable monitoring team would evolve through the use of project management ‘Core Team concept’.

Keywords: Value For Money, Core Team, New Public Management, Monitoring, PPP/PFI, Internal Capability

1. INTRODUCTION

Public-Private Partnerships (PPP) or Private Finance Initiatives (PFI) projects have become increasingly popular among governments across the world; this may not be unconnected with the fact that it helps provide public services faster and at the least cost to government. “Public Private Partnerships is a partnership that leverages private funding and the strengths of private entrepreneurship and management, for the maximum provision of public services in a climate of scarce resources. PFI is a PPP special case where all the finance needed for the capital funding and its basic operation is supplied by the private sector in return for a service charge” (Fewings, 2005). “PFI, in its purest form, is a Design, Build, Finance and Operate (DBFO) system. There are a number of factors that have given rise to the use of this procurement strategy and these factors differ from one country to another, while some believe it “offers better value for money than the Public Sector
Comparators (PSC) (Parker and Hartley, 2003), for others it is used to “manage design risks, time and cost overruns” (Fewings, 2005); in Malaysia, it is used “to attract private sector capital and expertise in developing infrastructure assets and services” (Siang, 2008). Internationally and particularly in developing countries, PPP/PFI is seen as attractive in terms of its capacity to achieve the transfer of technological knowledge to local enterprises and bring in international finance for local project development. Another reason for the thrust towards this procurement strategy is government desire to regain the amount of control it lost to the private sector under the various privatisation programmes coupled with the political risks and national security concerns.

However, in spite of what has been written about the benefits of PPPs/PFIs there are counter arguments, a study by (Blanc-Brude et al., 2009) observed that “the ex-ante unit construction cost of a road to the public sector is estimated to be 24% higher in a PPP than in traditional public procurement”, though they were quick to point out that the difference represents the costs of construction risks the private sector is saddled with. However, “whether PFI is, in fact, cheaper in monetary terms is difficult to assess because the project that results is not necessarily the same as that which would have been funded using conventional finance” (Froud, 2003). It should not also be forgotten that the public sector can borrow money more cheaply than the private sector. Most of the services outsourced under PPPs are critical infrastructures, which are “systems or assets vital to a country that any extended incapacity or destruction of such systems would have a debilitating impact on security, the economy, national public health or safety or any combination of the above” (Dunn-Cavelty and Suter, 2009). Public services “provide an infrastructure on which people can build autonomous and worthwhile lives” (Fisher, 1998), therefore, owing to the importance of these types of services there is a need to improve the internal capability of the public sector officials to properly govern, monitor, report and advise the government on all risk prone areas of the concessions.

This study seeks to highlight some of the skills required by public sector officials monitoring PPP projects and suggest ways of overcoming the present skills inadequacy; this has become necessary as the continued reliance on independent consultants to monitor these projects due to limited expertise in the public sector invariably increases the total transaction costs of the project to the public sector. A report by the National Audit Office in the UK found that “departments spent £789 million on consultants and an additional £215 on interims (temporary workers) in the years 2009-2010. In the same report, the spending on consultants was £904 million in 2006-2007, while the spending fell by £126 million in 2007-2008” (NAO, 2010). This practice can also lead to the loss of internal capability due to retiring or transferring staff as some concession contracts include staff transfer clauses. Another reason for the decline in PPP/PFI internal capabilities in the public sector can be linked to the New Public Management (NPM) which is a form of public sector reform being carried out across the globe; these reforms have come in the form of downsizing and cut backs on public spending. These downsizing have led to Independent consultants being contracted to monitor PPP/PFI projects, however the issues at stake is that they are private-for-profit organisations that do not share the same ideology of “social profits” with their Public Sector principals, the occurrences at Enron, WorldCom, Nortel and a number of other PPP/PFI projects have since shown that constant and effective monitoring of the activities of organisations providing public services by public sector official needs to be taken more seriously.

1.1. Investments in PPPS

In developing countries, “investment in infrastructure, particularly during the early stages of development, is of crucial importance as it sets the framework for subsequent investment by both public and private sectors (Todaro and Smith, 2009). “A joint Asian Development Bank, Japan Bank for International Co-operation and World Bank estimate is that East Asia alone has infrastructure needs totaling US$200 billion a year over the next five years. Around two-thirds of this expenditure needs to be new investment, with the balance on upkeep of existing assets” (Siang, 2008). In Taiwan, after the enactment of the PPP Act, “many public agencies have encouraged private sector entities to invest in public projects.

As of the end of 2008, private investment totaled nearly 382 billion NT dollars (about US$ 11.5 billion)” PCC, 2009, “the World Bank also found that between 1994 and 1999 the total private investment in Indonesian infrastructure was more than US$20 billion with private participation” (Abednego and Ogunlana, 2006).

Developed countries are also not left out of the PPP/PFI ‘party’ as PPP/PFI are not restricted to only “green field” developments but are also crafted to accommodate “Brown field” improvements. Broadbent and Laughlin (2003), in the UK, “the driving force for PFI is HM Treasury in the heart of the government. As a
result PFI is actively pursued with some 450 contracts worth over 50 billion pounds underway or completed”.

In the African sub-continent, speaking at a conference in South Africa, KPMG’s infrastructure and projects director for Africa Johan Greyling observed that “the continent was only spending about half of what was required to bridge the infrastructure backlog, at around $45-billion a year, when it really should be spending about $95-billion a year” (Prinsloo, 2011). In Malaysia under the Ninth Malaysian Plan, the government identified 425 projects worth RM 20 billion to be procured through PFI (Rashid, 2007), while in the present 10th MP, “52 high-impact projects worth RM63 billion have been identified for implementation” EPU, 2010.

1.2. The Need for Monitoring

Monitoring is an essential element for achieving project success, (Cleland, 1999) “Monitoring gives early warning of the possibility of contractor’s delays and helps in anticipating the consequences of changes that may be needed”. It is done to gather relevant information for the purpose of reporting to the relevant authority saddled with decision-making authority so that action can be taken to mitigate any risks which may threaten the attainment of the laid down objectives. “Environmental scanning generates a lot of information. That information only becomes knowledge when it is assessed against the values and beliefs of those in the organisation” (Doherty and Horne, 2002). PPPs in contrast to traditional procurement, encapsulate any public service supplied by a private firm, it could be a concession or a fully privatised entity, in as much as the government still regulates its operations especially service quality and price and is protected from competition, it falls under the category of a PPP/PFI, this distinction is provided by (Broadbent and Laughlin, 2003) who observed that “a key element in differentiating the two sectors (PFI and Privatisation) is the existence of a regime of state price regulations”.

Most PPP/PFI deals are undertaken using the Build-Operate and Transfer (BOT) or Design-Build-Finance-Operate (DBFO) models for those requiring “green field” developments before the contracted services can be provided. “However, some unsuccessful BOT projects alert us that BOT is not a sure-win business” (Tam, 1999), the success of a public sector project is not only in the interest of the profit-seeking private sector but also in the interest of the public sector that identified the need for the project in fulfilling their social responsibility of providing the project. “The concerns are not about technical abilities of the suppliers but rather the commercial and contractual maneuvering that is often employed at the expense of the overall project objectives” (Hall et al., 2003). In terms of financial reporting, “managers smooth or manage earnings upward to please investors” (Dechow and Skinner, 2000) cited in (Scott, 2009), however on the heels of the Enron scandal, these same managers adopted the opposite approach “to minimize wealth transfers from political solutions as predicted by the political cost explanation” (Scott, 2009).

In the UK also, “the National Audit Office has also criticised the profits made by private companies on certain PFI deals (NAO, 2008) cited in (Parker and Hartley, 2003), this type of occurrences coupled with failures like those experienced in Enron where regulatory laxity led to the loss of billions of dollars in equity investments, retirement benefits and unquantifiable ‘Social profit’ has brought the issues of effective monitoring to the fore.

In order to achieve success in any PPP/PFI project, (Tusk-Advisory, 2011) identified five components as being critical, these are:

- Political courage and legislative leadership
- Funding commitment and pipeline creation
- Regulations and governance of delivery
- Correct PPP model and optimal risk sharing
- Industry capacity and community support

Of all the above listed, Regulation and governance of delivery, is of paramount importance for PFI projects due to their uniquely long-term nature and the complex contractual and financial arrangements which are often dictated by the private sector supplier. The public sector has “social benefits” as its main objectives in PPP/PFI deals while the private sector seeks “return on investments” for its shareholders. El-Gohary et al. (2006) “the involvement of the private sector-with its profit-making mindset-usually raises concerns that are not likely when the asset is publicly owned”. Therefore with the public sector expected to be transparent in its transaction with private sector organisations, there is a lot of pressure on them to monitor performance and more recently environmental issues closely, this is because “fixed capital formation through PPP projects has become big enough to have macroeconomic and systemic significance in a number of countries” (Blanc-Brude et al., 2009). Hence “there are concerns that unless contracts are tightly specified, private firms might economise on the quality of output (Parker and Hartley, 2003) because “mega projects clearly bring together, under various contractual arrangement, differing and competing partners, interests, values and modes of rationality (ways of doing and thinking)” (Marrewijk et al., 2008).
1.3. The Challenges in Monitoring

PPP/PFI projects are usually let on the BOT or DBFO procurement method or other variants of it, therefore the skills required in contract administration of PPP/PFI is somewhat different from those the public sector were used to under the traditional procurement. “not only are PFI/PPP projects amongst the most complex from a management perspective, the differing objective between the public and private sectors and the public expectations can lead to difficult relationships” (Walker, 2007). “Social, economic, political and technological change is inevitable: while the details of changes cannot be accurately predicted, the fact of change is inescapable and is one of the distinctive hallmarks of a progressive society” (Froud, 2003) commenting further on the uncertainties inherent in long-term contracts (Parker and Hartley, 2003) observed that “It is difficult to write complete contingent claims contracts (allowing for uncertain events) especially where contracts cover lengthy period of time, technologies and costs are inherently uncertain or the economic environment is in a state of flux”, hence “If government relies on third parties and empowered employees to achieve public purposes, it will have to monitor their performance” (Rosenbloom et al., 2008).

Essentially, (Doh and Ramamurti, 2003) “Governments serve four important roles in infrastructure namely:

- Sponsor/investor
- Consumer/Customer
- Rule maker/Regulator
- Mediator/Moderator of political opposition

Figure 1 above shows the dependence of the public sector on external consultants. This results due to the inadequate PFI contracting skills within the public sector. The effects include increased transaction costs, resulting from the professional fees of the various consultants that would be engaged throughout the life cycle of the project and the further decline in the public sector’s internal capability, due to prolonged lack of engagement of its staff who should be learning PFI-related skills through their involvement on projects. In another work (Jacobs, 1994), noted that “Governments throughout the world engage in three main activities: They tax, they spend and they regulate. Regulation is the least understood”. Brux (2010) also observed that “Public sector has weak expertise in negotiations and contract governance”. The challenges may come in the form of technical or technological, financial, contractual, environmental, risk
management and stakeholder management challenges. “The public procurement workforce of today is supposed to master all these contracting skill areas, as well as others and also to conduct operations in innovative ways” (Lawther and Martin, 2005).

1.4. Inadequate Technical Skills

There are a lot of technical challenges confronting the public sector officials on PPP/PFI projects and this result from their changed role of specifying inputs under the traditional procurement. “To control quality the public sector moved from input specification as a benchmark for comparing bid prices to a normalised position of procuring services upon performance criteria established in output specifications; Key Performance Indicators (KPIs) being used to ensure requirements are met over project life cycles” (Smyth and Edkins, 2007). This new position has sprung its own challenges, (RICS, 2003) found that “managers are often not adequately skilled at driving PFI projects forward and that in the best PFI projects a partnership of skills between the public and private sectors is required” while (Li et al., 2005) noted that “the concept of PPP is comparatively less well understood in countries with a strong public welfare policy” and “public procurement partnerships create administrative and implementation challenges for public procurement professionals that are not found in more traditional procurements” (Lawther and Martin, 2005). “The lack of understanding and the need for better training by public officials involved in PPP/PFI projects is a major issue” (Morledge and Owen, 1998).

1.5. Inadequate Financial Management Skills

The financial monitoring in PPP/PFI projects is somewhat unclear; this is because the public sector is not committing any monies to the project under a ‘pure’ PFI project. However certain decisions of the government can affect the finances of the private sector provider, for instance the interest rates, would affect the cost of capital to the private sector. Another issue is in the area of re-financing, some private providers usually seek re-financing after the contract has been entered into with the government in order to get more favorable repayment terms, though in some countries such as the UK, provision has now been made for both parties to share the gains of such re-financing deals, but in reality this has not be truly achieved. There has evolved new financial instruments developed by the private sector in collaboration with financial institutions to increase profitability and retain their shareholders. In a study by (Scott, 2009), he observed that during the post-Enron era, “firms used several accounting charges including special items, discontinued operations, asset write-offs and goodwill impairment charges to decrease reported income. Before political sensitivity, the majority of special items in the industry were income increasing”.

The public sector lacks adequate knowledge of these financial maneuverings and has led to situations where “the unitary charge is itself derived from a financial model of the provider’s entire forecast cash flows which include financing and borrowing” (Cartlidge, 2012).

1.6. Inadequate Contract Administration Skills

PPP projects are a bit different from the traditional procurement method which many public sector officials have become used to over the last few decades, one of the major differences is in the mode of evaluation and payment for work properly done. Where under the traditional procurement methods during construction, work properly done till date is valued by professionals or consultants working for the client and advises the client on what amount is due the contractor under ‘interim certificates’, on PPP/PFI projects the contractor is responsible for financing the project and starts earning once the project is functional. “Services contracting, information technology and knowledge development all require specialised contracting expertise and skills” (Lawther and Martin, 2005). Furthermore, the “PPP/PFI imposes a new and more complex procurement process on the public sector, it is part tendering and part contract negotiation among public bodies, private sector consortia and their advisers” (Li et al., 2005).

1.7. Risk Management Expertise

Proper risk management is another area where the private sector is ahead of the public sector, this is because they are more enterprising and are always on the lookout for anything that will threaten their profitability. “However, with the advent of NPM and the adoption of modern procurement methods there is increasing understanding that financial aspects of projects are influenced by the good management of risks” (Grimsey and Lewis, 2002), “a 2009 review by the Office of Government Commerce (OGC) in the UK found that 44% of Senior Responsible Owners of major projects did not have any substantial commercial experience” (NAO, 2009). For “multinational companies that are project driven, risk management takes on paramount importance. Not all companies, especially in undeveloped countries, have an understanding of risks management or its importance. These countries sometimes view risk
management as an ‘over-management’ expense on a project (Kerzner, 2006).

1.8. Stakeholder Management Skills

The civil service has always carried with it the image of just delivering public services to the general public without recourse to whether the populace are satisfied or not since they do not look forward to being blamed individually or fear losing a comeback to their positions because they are not usually elected into these government agencies. This realisation has limited their eagerness to learn people management skills which could come in handy when monitoring projects where people issues create a threat to the successful execution of such projects. Hence when conflicts occur, especially within the private partner’s team or between other stakeholders affected by the project, the public servants often shy away from interfering not realising that these conflicts have a direct impact on the project at hand and will reflect on their performance. In dealing with these conflicts, “the project sponsor is ideally placed to identify issues of concern and areas for improving management practices within the construction project management” (Hall et al., 2003).

1.9. Lack of Environmental Management Knowledge

Global warming has added a new chapter to the ‘book of skills’ required by the public sector project sponsors and their representatives. “Sustainability is a recent major issue that has emerged as a powerful environmental force on the construction industry” (Walker, 2007). It is usually difficult for the private sector provider to integrate it unless the public sector client insists on it, this is because of the additional costs of hiring ‘green experts’ to advice on sustainability related issue on a project. “It is possible for public services to score highly on the traditional 3 ‘E’s of Economy, Efficiency and Effectiveness, while failing to meet the needs of the community” (Flynn, 1997) cited in (Doherty and Horne, 2002). The public sector monitoring teams owe it as a duty to protect the end-users, community and the government from the effects and repercussions of this issue. However, recently there has been a reinvigorated pressure for the consideration of environmental impact of not only PPP projects but all other human activities, this has further raised the bar of skills required by the public sector officials divided between providing the much needed infrastructure services yet protecting the environment from the damaging effects of construction activities and processes through which these infrastructures are provided.

Fig. 2. Core team structure, Source: (Wysocki, 2007)

1.10. Overcoming the Challenges-Some Suggestions

One of the major reason for low internal capability of PPP/PFI skills in the public sector is staff shortage, however (Doherty and Horne, 2002) “Shortages of trained staff cannot be solved in the medium term by more money. Existing staff need to be managed more efficiently and more individually”. This shortage of staff is occasioned by staff transfers to the concessionaire in line with NPM resulting in reducing the government administrative load and wages commitment to these staff. In the UK, “from 1995 to November 2004 it is estimated that 35,000 staff transferred from the public to the private sector as a result of PPP/PFI (Partnerships UK) cited in (NAO, 2008). To manage the shortfall of qualified staff created by these transfers, the project management Core Team approach (Fig. 2) should be implemented in order to bring together the available experts to form a pool of critical resources required across all project types. A core team “comprise of a small number of Subject Matter Experts (SMEs) chosen and managed by the Core Team Manager. The SMEs of the core Team consult, advice and support the work of all the teams working on the project” Wysocki (2007). Andrew and Sofian (2011) in their study on engaging people who drive execution of organisational goals found that co-
employee support was a major driver that influence job engagement and organization engagement. Hence, engaging employees by the public sector in all areas where PFI skills are required would help enhance their on-the-job experience and ensure the success of such projects and future ones.

As has been observed by many commentators on PFI and its contractibility, “It is difficult to write complete contingent claims contracts (allowing for uncertain events) especially where contracts cover a lengthy period of time, technologies and costs are inherently uncertain or the economic environment is in a state of flux (Parker and Hartley, 2003). Therefore it becomes pertinent for the public sector officials to be well aware of this and try to create an environment of mutual respect between both parties while not taking their eyes off the main objectives of the project.

Policy monitoring is another area which requires attention, “as the authority-in-charge of public Participation in Infrastructure Projects (PPiP) in Taiwan, Public Construction Commission (PCC) actively promotes private participation, enhances the coordination and assistance in each PPI project and facilitates regulation relaxation. Its purpose is to expand the scope of PPIP and improve the environment for its implementation.” PCC, 2009. The private sector also benefits from effective project monitoring; this much was evident in the New Pantai Highway project (in Malaysia) where “the government agreed to revise the concession agreement to take into consideration the actual situation of problems caused by squatters (Rashid, 2007). Had there not been effective on-site monitoring, disputes would have arisen as to the extent to which the squatters impacted the progress and performance of the project.

Public servants with sector-specific skills should also be included in the monitoring team, where they are not available there should be a concerted effort to attract and retain them within the public sector with good remuneration packages. Writing about ethics in water management, (Moorthy and Jeyabalan, 2011) concluded that “it is fundamental to infuse the knowledge of ‘water ethics’ among water managers, institutions and the general public and into water policy formulation and implementation initiatives”

Like in all activities involving monitoring, proper documentation is required so that (Berggren and Soderlund, 2008) “Individual learning can be turned into collective learning and individual learning can be further developed if articulated by writing reflection reports” this is why “managers in public services are increasingly required to act as coaches and mentors and to ensure that employees develop the knowledge and understanding that underpin a broad range of competencies (Doherty and Horne, 2002). Finally, “a cooperative and uncorrupted supervising authority is required in managing BOT contracts” (Tam, 1999).

2. CONCLUSION

Value for money is at the heart of any government procurement, with the government being the largest client of the construction industry and other numerous industries at least in developing countries, there is a need for its staff to be well equipped in all the rudiments of contract administration especially now with the thrust towards PFI. Monitoring of projects helps anticipate difficulties that may hinder the success of such project. This has become even more important with public services at the heart of PFI procurement. A breakdown in these services would not augur well for government and the people it serves, therefore internal capability of the public sector to monitor these projects and report them efficiently has become necessary in order to provide credible information to the government or the empowered authority to take rational decisions. However, in order to solve any problem, an acknowledgement of the existence of that problem must come first. In this context, the evolution of PPP/PFI has brought with it unique challenges which the government must live up to if it wants to retain the trust and loyalty of its citizens. Most PFI project failures have only come to light after a lot of damage has been done and the losses suffered in terms of social profits cannot be quantified in monetary terms to enable adequate compensation to be sought from the private provider or government. Therefore, it is in the interest of the governments to ensure that their bureaucracy are well equipped to help prevent these failures through improved skills in monitoring and reporting on the progress and performance of PFI projects. Around the world today, citizens are becoming more aware of their rights upon their government, if nothing, the recent ‘Arab Spring’ is one “party no government would want to be invited to”

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4. REFERENCES


