

# Government investment in PPP: Re-evaluating value for money

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## Background

Many high profile public sector projects from a variety of different procurement routes have been guilty of overruns in terms of cost and time, and therefore failed to deliver the promised benefits. This has resulted in a growing awareness on the part of national governments to associate and balance the need for economic competitiveness in infrastructure projects with the quality of the final product.

The repercussions of construction project failure have resulted in officials adopting, examining and promoting the term 'best value' (BV). The UK Labour government introduced the term into procurement in 1999, defining it as securing economic, efficient and effective services, and it has been refreshed by the current coalition government. One of the 'best practices' identified under the 'economic' category of the BV policy was providing Value for Money (VFM). Since then there has been much discussion of VFM in government circles in relation to procurement to ensure that money from the taxpayer produces the maximum positive result.

HM Treasury<sup>1</sup> provides the UK Government definition of VFM as the 'optimum combination of whole life costs and quality'. The UK Government requires the following four issues to be addressed within the procurement process to achieve VFM:

- Ensure that no bias exists in determining the procurement method adopted
- Quality and service must both be considered in analysing VFM. This ensures that in any particular procurement lowest cost is not the paramount reason for accepting a bid
- That the obligation to provide VFM does not negatively impact on employment terms and conditions for those who transfer to the private sector
- Assessment of the whole life costs and benefits and associated risks is essential

There are many different ways in which construction can be procured. The most common route is known as the 'traditional route'. The now disbanded Office of Government Commerce (OGC)<sup>2</sup> defined this route as following a 'design-bid-build' process. In order to achieve the goal of VFM, the UK Government

suggested that a move away from the traditional procurement route was needed.

From 2000 onwards, the OGC, whose role has now been taken over by the Cabinet Office, has provided advice through the adoption of the 'Achieving Excellence' documentation. This stated that only three procurement options would be available to UK public sector departments. These were the Private Finance Initiative (PFI), Prime Contracting, and Design and Build.

Within the public sector, the problem of the need to meet global infrastructure requirements is jaw dropping, estimated in cost at US\$57 trillion between 2013–30.<sup>3</sup> This clearly supports the statement in the 'Infrastructure to 2030' series of reports<sup>4</sup> that states that the need to provide infrastructure will outpace the capacity of national governments to provide it. Therefore the public-private partnership model (of which PFI was a subset) has a large role to play due to its leverage of private finance.

## Public-private partnerships

Initially, the term Private Finance Initiative (PFI) was used to define a variety of practical long-standing relationships between public and private sectors. When Labour came to power in the UK it enveloped the term under the umbrella term public-private partnerships (PPPs). PPPs are governmental long-term contractual relationships with organisations from the private sector enabling construction, management or both of public sector infrastructure projects.

The European Commission<sup>5</sup> defines the construction and management element of PPP schemes as including funding, design, construction or renovation, maintenance and management but they avoid complete privatisation. Conversely, the PPP route also provides the prospect of avoiding some of the hazards of full public ownership including bureaucracy, corruption and inefficiency.

At the end of 2012, the UK Government announced the start of a revised policy named Private Finance 2 (PF2).<sup>6</sup> This actively encouraged a more collaborative attitude between the private and public sectors to improving project performance and managing the allocation of risk. Transparency in relation to project information and costs through public sector membership of the project board

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Eadie, R., Millar, P. and Grant, R. (2013) *PFI/PPP, private sector perspectives of UK Transport and Healthcare*, Built Environment Project and Asset Management, Vol. 3. No. 1.



*Quality and service must both be considered in analysing value; lowest procurement cost may not equal lowest whole-life costs*

could also be achieved. The public sector would share in any return on investment. The changes mean that early stage analysis of a project becomes even more vital.

As PPP schemes include construction and maintenance over a long period of time, 25 years or more, a report by the United Nations Economic Commission for Europe UNECE<sup>7</sup> emphasises the importance of a full pre-project cost-benefit analysis. According to the report, the quantitative benchmark for a cost-benefit analysis for partnership projects is the Public Sector Comparator (PSC).

The PSC is a hypothetical risk-adjusted costing<sup>8</sup>, used by the public sector as part of the procurement process. It is used as a benchmark to judge VFM on PPP schemes. This allows an individual assessment of each scheme.

## Success in public-private partnerships

When assessing the use of a PSC, the results of academic research, in a survey of 50 organisations which worked on UK PPP projects, indicated that in the direct aftermath of recession 60 per cent of respondents stated that they could not determine whether the benefits of PPP outweigh the drawbacks without considering each project individually<sup>9</sup>, emphasising the need for use of a PSC. It also determines that the choice of PPP as a procurement route does not guarantee a positive outcome by default. It further confirms the validity of the UK Government VFM guidance that a project specific assessment procedure is required.

Much discussion has taken place in the House of Commons on the use of PSCs to determine VFM. Yet in the findings of our research, only ten per cent of respondents expressed concern that since PSC is used very early in the procurement process, the comparison may not be realistic. It seems clear therefore that there are no statistical grounds which warrant terminating their use given 90 per cent of practitioners advocate their use in appropriate circumstances.

The realisation of the effects of a global financial crisis and its impact in recession did not deter a much higher percentage (28 per cent) of respondents considering the benefits of PPP to outweigh the perceived drawbacks, than vice versa (ten per cent). This is even in a climate where debt finance is restricted and illiquidity was at an all-time high due to the financial crisis. This indicates that PPP remains a valid procurement route even when financial circumstances are juxtaposed and therefore still has a place in helping governments and organisations provide infrastructure and services in times of austerity.

When considering the main factors affecting the choice of procurement route, 68 per cent indicated that although achieving VFM is important to the government when undertaking PPPs, it is not always the overriding factor. Further work from 49 respondents working on PPP projects in the transport and health care sectors shows that transfer of risk, speed of construction and finance through PPP schemes are also positively viewed as providing facilities not realisable within state fiscal constraints. These are shown to be the main reasons for adopting the PPP procurement route.<sup>10</sup>

**Table 1: Key performance indicators**

Client satisfaction – product	Rank 1
Client satisfaction – service	Rank 2
Profitability	Rank 3
Construction – cost	Rank 4
Productivity	Rank 5
Construction – time	Rank 6
Predictability – cost	Rank 7
Predictability – time	Rank 8
Defects	Rank 9

The ambivalence over whether VFM was the main criteria for adopting a PPP procurement route for an infrastructure scheme was emphasised by the results of a further study with 56 responses. This indicated that although PPP is used when finances for direct payment for facilities are not available, a combination of recession and austerity measures had led to a four per cent drop during recession and forecast a eight per cent reduction in spending on PPP schemes as the UK exits recession.<sup>11</sup> This was unexpected as it was thought that during a recession the amount of schemes procured under this route would increase, and the findings were just prior to the government's promotion of PF2.

A further interesting finding of our research is that the importance of the key performance indicators (KPIs) used to determine the success of construction projects is different for PPP projects. With the exception of safety, the KPIs were ranked in order of importance. Table 1 provides a list of the headline KPIs and their ranking.

It can be seen from the research the two KPIs which were deemed most important were 'client satisfaction – product' and 'client satisfaction – service'. The least important was deemed to be 'defects'. It seems reasonable that satisfying the most highly ranked KPIs results in the impact of 'defects' being minimised. In times of recession, client satisfaction is vital to achieving VFM and to the survival of the organisations completing and maintaining the works. Comparison with other research indicates that KPIs perform differently in PPP schemes than in general construction.<sup>12</sup>

Construction cost was only ranked fourth showing there is a disconnection between the overall cost and construction cost on PPP schemes. Negatively, the responses to academic research indicate the most important disadvantages related to cost elements within PPP schemes.<sup>13</sup> This was due to contractors building costs for risk into their tender price. Furthermore, from the empirical data gathered it can be concluded that contractors' prime motive is maximising profit and not necessarily providing VFM. Respondents from the transport sector clearly indicate that PPP projects are more expensive to the client in the long term and they find it difficult in the current market to get funding at competitive rates.

Despite these reservations PPP was still chosen as the preferred procurement route for providing BV. PPP was substantially more popular in health care (65 per cent) than in transport (48 per cent). This indicates that satisfaction with PPP schemes differs depending on whether it is related to buildings or transport. The advantages and disadvantages of PPP were ranked within the research for health care and transport schemes.<sup>14</sup> The findings showed that the most

important advantage of the PPP procurement route to the health care sector was that it allowed organisations to take advantage of the private sector's experience and skills. For the transport sector, the most important asset of PPPs was their use to maintain facilities over the contract lifetime. The findings would appear to indicate that the complexity of a building determines the rating (as health care facilities are more complex than highway schemes).

## Conclusions and recommendations

The research has shown that there is still majority support for PPP despite a measure of distrust in PPP schemes in providing VFM (in financial terms). This indicates that PPPs are here to stay and are still a viable way to procure work even in times of recession.

To ensure this viability, the importance of using a method to determine the suitability of a scheme for PPP procurement is vital for project success. One of the ways supported by industry is via a PSC on a case-by-case basis. As part of this, factors other than just financial must be taken into consideration, as achieving VFM is not always the overriding factor in choosing PPP as a procurement route. The types of use for PPP schemes has been shown to be very important as complex building schemes relied on PPP to involve the private sector's experience and skills whereas the issue of maintenance was more important in transport schemes.

In moving employees from the public to the private sectors, the Transfer of Undertakings (transfer of employment) Regulations (2006) appear to have substantial support from the management perspective and are key to getting buy-in. Therefore, countries without such regulations should seek to put similar protocols in place before large-scale adoption of PPP schemes.

The ranking of the KPIs from the perspective of the economic operators involved showed that they were interested in maximising profits. This shows that the UK Government was correct in attempting to get a share of these profits through the release of the PF2 style of PPPs.

The lack of government ability to fully finance infrastructure needs in the future will ensure that PPP schemes will be required. However, the nature of these schemes will need to further evolve with changes such as those made in PF2 to meet the needs of a fluctuating economic environment.

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