

THE MALAYSIAN PRIVATE FINANCE INITIATIVE AND VALUE FOR MONEY

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Abstract

The concept of value for money (VFM) is the fundamental reason for most Private Finance Initiative (PFI) projects to be attractive in many developed and developing countries. The concept encourages governments to deliver Mega projects by using PFI procurement method. The aims of this paper are first, to investigate the notion of VFM for PFI projects by different countries (i.e. UK, Australia and Japan) and second, to discover the detailed components of Public Sector Comparator (PSC) protocol to evaluate VFM.

Based on the consideration of these models, the paper proposes a framework of VFM assessment for PFI projects in Malaysia. In this framework, VFM assessment is designed to embrace the four phases of project life cycle (programme, project, procurement, and project construction phases). The implementation of VFM across project phases is needed to achieve project effectiveness (optimal risk sharing, cost saving, time saving, quality improved, client satisfaction and benefit to public) and to establish PSC guideline in the evaluation of VFM.

Keywords: Malaysia, private finance initiative, public sector comparator, value for money

1. Introduction

PFI was originated in England in 1992 under the United Kingdom's Tory-led government of John Major (Williams, 2005). PFI is one type of Public-Private Partnerships (PPP) where project financing rests mainly with the private sector (Akintoye et al. 2003). The rationale of PFI is to combine the resources of the public and private sectors for the purpose of providing more efficient public services. In some cases, the capital invested in a project is financed, constructed and leased back to the private sector over a pre-determined period of between 25 and 30 years. This is in line with a number of empirical studies by various researchers (Akintoye et al., 2003; Zhang, 2005; and Pitt et al., 2006) indicating that PFI is a method in which project delivery rests mainly with the private sector, which includes designing, constructing, financing and operating the asset. The basic idea of PFI as noted by

Shinohara (1998) is based on the concept that public sector purchases “public services provided by private sector to increase the quality and deliver value for money”.

PFI in Malaysia was officially implemented by the Malaysian Government through the Ninth Malaysia- Plan (2006-2010) under the National Privatization Plan (EPU, 2006). It is among the effort by the Malaysian Government to encourage private participation in the local development projects and to reduce government’s expenditure in providing public infrastructure and services. Despite PFI being perceived by most governments as the most cost effective means of procuring public infrastructure projects, a debate about the nature and method of achievement of VFM in PFI project is still disparaging (ACCA Survey, 2002). The probable reason for this predicament is due to the difficulty of measuring project outcomes because of the complexities in PFI projects (Broadbent et al., 2003; Heald, 2003; Shoul, 2005 and Khadaroo, 2007). Studies conducted by Shoul (2005) and Leigland & Shugart (2006) claimed that the complexities of most PFI projects lead to the difficulties to measure VFM for the outcomes. To a certain extent, only one percent of the respondents strongly agreed that PFI generally provides value for money as reported by the ACCA Survey.

The core test of VFM for PFI project is determined through a comparative analysis of the benefits, risks and costs by using both quantitative and qualitative analysis (Grimsey & Lewis, 2005). According to them, there are four main alternative approaches to provide the core test of VFM. These could be done by using full cost benefit analysis, Public Sector Comparator-Public Private Partnership (PSC-PPP) comparison, UK style PSC –PPP, and competitive bidding. Among others, the UK style PSC- PPP comparison has been adopted by many countries such as Australia, Hong Kong, Japan, and Canada. Nevertheless, the method has come under growing criticism, in terms of whether PSC calculation is the most appropriate way to evaluate VFM due to the ambiguity and complexity problems.

Hence, this study investigates two fundamental issues: first, the notion of VFM for PFI projects undertaken in different countries such as UK, Australia and Japan, and second, to examine PSC as a tool in VFM assessments. The research findings will then form the basis for a proposed model that targets PFI projects in Malaysia.

2. PFI in Malaysia

Since 1983, the Malaysian Government has advocated many new forms of PFI modalities such as Built, Operate and Transfer (BOT), Built and Operate (BO), Built Lease Transfer (BLT) for new projects and outright sale, lease, management buy-out and corporatisation for existing projects (Abdul Rashid, 2007). The main aim of PFI is to encourage private participation in the local construction development and to reduce government’s expenditure in providing public infrastructure and services. The Government sectors that are responsible for establishing the PFI Central Unit include the Ministry of Finance (MoF), Economic Planning Unit (EPU), and National Implementation Directorate (NID). In order to facilitate the implementation of PFIs, the Ministry of Finance Malaysia has acquired a substantial amount of funds to facilitate the first wave of PFI implementation in Malaysia (Jayaselan and Tan, 2006).

The Employee Provident Fund (EPF) Department has agreed to invest RM 20 billion in terms of loan to facilitate PFI projects under the Ninth Malaysia-Plan (EPU, 2006). The structure of PFI in Malaysia starts by establishing PFI project agreement which is entered into between the Public sector (represented by various government ministries) and the Special Purpose Vehicle (SPV) Company (private consortium). The PFI Sdn Bhd, a specific government body is set up to administer the Malaysian PFI procurement process. PFI Sdn Bhd borrows money from EPF to finance selected projects under the Ninth Malaysia-Plan. The commitment of PFI Sdn Bhd is to design, construct, operate, manage and maintain the facility throughout the concession periods (Tan et al. 2006). Therefore, the risks associated with the project include the risk of construction, management, and maintenance of the assets. In return, the Government is contracted to pay for the services based on performance and standard provided. Future tariff revisions are also to be subjected to a Reward-and-Penalty system (Express et al., 2006 and Kok et al., 2006). The evaluation of a project proposal is done through a bidding process and all proposals will be evaluated on the basis of VFM which evaluates its costs and benefits. The bidding proposal is compared against the PSC of each project, which acts as a checker to the items and costs stipulated in the tender document. The capital expenditure and the maintenance costs of the project must be less than the PSC benchmark before a PFI project could be awarded to a private partner.

3. VFM in PFI Projects

VFM is defined as the ‘optimum combination of whole-life costs, benefit, risks, and quality (fitness for purpose) to meet user’s requirements at the lowest possible price’ (HM Treasury, 2003; Grimsey and Lewis, 2005; English, 2006 and Hong Kong PPP Guide, 2006). It is usually associated with three Es, i.e. Economy, Efficiency and Effectiveness (English & Guthrie, 2003; Grimsey and Lewis, 2005 and Shoul, 2005). Therefore, in seeking VFM for PFI projects, three initial strategies should be deployed by most governments. These are: effective evaluation mechanism, viability of PFI contractor, and commitment to VFM. It is important that VFM assessment should take place at the earliest practical stage of any decision making process. The process to confirm VFM within PFI procurement is gradual. VFM is assessed by comparing a cost of PFI bids against a PSC. Theoretically, the project considers VFM if the net present value (NPV) for PFI bids is lower than the PSC. The baseline cost of the PSC is usually based on historical costs for services and adjusted based on project future demand, demographical changes and political consideration. Long-term forecasting requires assumptions to be made about the future. Once the NPVs of both PSC and SPV have been prepared and adjusted to a comparable basis, then a simple comparison of both will be undertaken.

4. Methodology

Initially, this study is purely based on literature review. It reviews theoretically VFM assessment models applied in the UK, Australia and Japan. The aims as stated previously, are to investigate the notion of VFM for PFI projects by these countries and to discover whether PSC protocol is the most appropriate way to evaluate VFM with a view to propose a model that targets PFI projects in Malaysia. Further, a comprehensive empirical research in the form of a triangulation approach (questionnaires and case studies), followed by validation of framework are planned for future work.

5. VFM Assessment Models

Table 1 shows the VFM assessment models for PFI projects adopted by the UK, Australia, and Japan. These models were chosen in this study due to their long period of establishment i.e. since 1990's and their good track records in terms of performances that could be learned, in particular from the VFM point of view. Indeed, the UK is the pioneer of PFI and the inventor in the form of the VFM assessment approach. These models are discussed in turn:

5.1 The UK VFM Assessment Model

The UK VFM assessment model of PFI project by Grimsey & Lewis (2005) and Pit et al. (2006) outlines a process which starts by looking into key assessment criteria of VFM assessment. These are affordability, risk sharing and competition. Affordability means the appropriately allocation of resources, cost distribution and within the budget; risk sharing refers to the optimum allocation of risk between private and public sectors; and competition means contestability in the market (i.e. in the bidding and in the operation processes). The UK model has adopted PSC as a tool when assessing VFM. In making a robust assessment of PFI projects, VFM appraisal takes into consideration of the financial element (NPV) and qualitative factors (merit base). The VFM testing of the PFI option and the PSC should employ economic appraisal principles which include: identification of costs and benefits, calculation of NPV, analysis of uncertainties, weighting of other factors and presentation of performance result. The performance result of VFM is demonstrated when the project shows a reduction in cost, innovation in quality and appropriate level of project risk. However, there are some barriers identified in implementation of PSC such as: being too subjective, simplistic and the presence of unquantifiable and risky elements. In addition, Pit et al. (2006) also reckon several VFM drivers in the UK model and these drivers are needed to drive PFI projects to the effectiveness of a project outcome.

Table 1: VFM assessment for the UK, Australia and Japan

Variables	UK VFM Model (<i>Grimsey and Lewis, 2005</i> and <i>Pit et al. 2006</i>)	Australian VFM model (<i>Partnership Victoria,</i> <i>2006</i>)	Japanese VFM model (<i>Mori, 2006 and Kajita,</i> <i>2007</i>)
Key assessment criteria	<ul style="list-style-type: none"> • Affordability • Risk Sharing • Competition 	<ul style="list-style-type: none"> • Affordability • Risk Sharing • Competition 	<ul style="list-style-type: none"> • Affordability • Risk Sharing • Competition
VFM Tools	<ul style="list-style-type: none"> • PSC 	<ul style="list-style-type: none"> • PSC • PIT 	<ul style="list-style-type: none"> • PSC
VFM Appraisal	<ul style="list-style-type: none"> • Financial (NPV) • Qualitative (merit base) 	<ul style="list-style-type: none"> • Financial (NPV) • Qualitative (merit base) 	<ul style="list-style-type: none"> • Financial (NPV) • Qualitative (merit base)
Barriers	<ul style="list-style-type: none"> • Subjective • Simplistic • Risk 	<ul style="list-style-type: none"> • Inaccuracy • Omitted risks • Manipulation • High cost 	<ul style="list-style-type: none"> • Complexity of procedures • Bureaucracy • Lack of a transparency
VFM Drivers	<ul style="list-style-type: none"> • Risk allocation • Output specification • Competition • Contract duration • Innovation • Borrowing cost • Management skills • Performance measurement • Contract flexibility 	<ul style="list-style-type: none"> • Measurable service output. • Whole life costing • Integration of design, operation and maintenance • Innovation • Risk transfer • Greater asset utilisation • Market capability 	<ul style="list-style-type: none"> • Government support • Deregulation • Private sector capability and expertise • Risk • Capacity of financial markets
Comprehensive VFM concept	<ul style="list-style-type: none"> • Economy • Efficient • Effectiveness <p><u>Achieving :</u></p> <ul style="list-style-type: none"> • Optimal risk transfer • Efficient public services • Innovative design • Leveraging private sector 	<ul style="list-style-type: none"> • Economy • Efficient • Effectiveness <p><u>Achieving :</u></p> <ul style="list-style-type: none"> • Optimal risk transfer • Efficient public services • Innovative design • Leveraging private sector 	<ul style="list-style-type: none"> • Economy • Efficient • Effectiveness <p><u>Achieving :</u></p> <ul style="list-style-type: none"> • Optimal risk transfer • Efficient public services • Innovative design • Leveraging private sector

Source: *Grimsey and Lewis (2005); Pit et al. (2006); Partnership Victoria (2006); Mori (2006) and Kajita (2007)*

The assessment of VFM concept in this model can be regarded as complex. It involves the preparation of a hypothetical set of costs of a project, evaluation of risks and financial benefits. To assess VFM therefore, it requires an ability to define, estimate its related outcome and to compare it against a PSC. Thus, the project will achieve VFM in terms of comprehensive costing, quality, performance and risk allocation. Nevertheless, the absence of capital funds in PSC calculation is a weakness of the model.

5.2 The Australian's VFM Assessment Model

The Australian VFM assessment model is quite similar to the UK model which also takes into consideration the key assessment criteria, VFM appraisal, PSC, drivers and barriers. However, the dissimilarity is by having an additional assessment tool i.e., public interest test (PIT) apart from public sector comparator (PSC). The primary purpose of the PSC is to provide a quantitative benchmark against which to judge VFM of bids. The use of PIT on the other hand, is to ensure that a broader assessment of the public interest is to be taken into account before they can be offered as Private Finance Project (PFP). Essentially a checklist is needed by PIT and the components of the list include project effectiveness, impact to stakeholders, public access and equality, consumer rights, security, privacy and other associated non-economic costs and benefits (English & Guthrie, 2003).

5.3 The Japanese's VFM Assessment Model

Following the perceived success of PFI efforts in the UK, the 'PFI Law of Japan' was enacted in 1999 (Japan PFI Association, 2007). Since then, more than 200 PFI projects have been launched involving various sectors, i.e., public facilities, official facilities and public utilities. The Japanese PFI utilizes the concept of the UK PFI modified to include the Japanese styled subsidies. Construction and application of PSC is an integral component in the VFM assessment. VFM is demonstrated by comparing private sector bids with a detailed PSC. The calculation and confirmation of VFM is required from project planning stage. The business period of PFI projects usually lasts for 25-30 years and hence, the NPV method is used for the assessment of VFM. The total incomes and costs of a PFI project (including running costs) are converted into NPV to assess the value for the PFI project. The assessment for VFM considers both the quantitative and qualitative factors, which are identical to the UK and Australia practices. There are some forms of government support specified as key drivers under VFM Japanese model including interest free loan from the government finance institution and tax measures.

5.4 VFM in Malaysia for PFI Projects

In the context of Malaysia, a PSC approach is used to measure VFM for PFI projects. The tender bids will be benchmarked against the PSCs which remain confidential. It is likely that the Public Works Department will play a key role in drawing up the PSCs for most of the standard construction projects. The formation of PSC is fundamental to the success of PFI projects and appears to be used as a test to achieve VFM. For genuine efficiency and value for money, it is essential to ensure that contracts are awarded on the basis of capability and ability of the PFI contractor. Typically, the involvement of government is essential in particular, at project planning stage. A set of performance standard is incorporated, while modes of payment are also stipulated. Nevertheless, the establishment of a PSC guideline with regards to VFM for PFI contracts is yet to be established (Jayaseelan and Tan, 2007). This is vital for the fact that PSC is subjected to limitations, while VFM is a problematic concept which is hard to operationalise in PFI contracts.

6. A Proposed Framework of VFM Assessment for PFI Projects in Malaysia

Based on the preliminary literature review and the understanding of VFM assessment models adopted by various countries (the UK, Australia and Japan), a proposed framework for VFM assessment is developed as illustrated in Figure 1. In this framework, VFM assessment is designed to embrace the four phases of project life cycle (programme, project, procurement, and project construction phases). The implementation of VFM across project phases is needed to achieve project effectiveness (optimal risk sharing, cost saving, time saving, quality improvement, clients' satisfaction and benefits to the public). The three assessment criteria (affordability, risk sharing and competition) are prime factors for the assessment to begin with. In addition, a VFM assessment tool by using PSC is used as a benchmark against the tender bids before and after bidding.

Further, the procuring process should consider the evaluation factors from the quantitative (financial elements), qualitative elements (i.e., bidder's background, design etc), non-financial benefit analysis (social obligation) and long term analysis to be formulated into a robust assessment approach. The inclusion of social effect is based on the high commitment of the government on its role as a caretaker of the public at large and the social obligation that are naturally attached to it. VFM drivers in terms of supports from the Government and financial institutions and contract flexibility (Pitt et al., 2006 and Nisar, 2007) are seen to be vital to achieve the ultimate effectiveness of project outcome. The remarkable modification of this framework from those suggested by Grimsey and Lewis (2005), Pitt et al. (2006), Partnership Victoria (2006), Mori (2006) and Kajita (2007) is that it recognises the need for the client to assess VFM at various project phases. A more extensive empirical study on the proposed framework is proposed for future work, in particular to validate the effectiveness of the proposed framework.

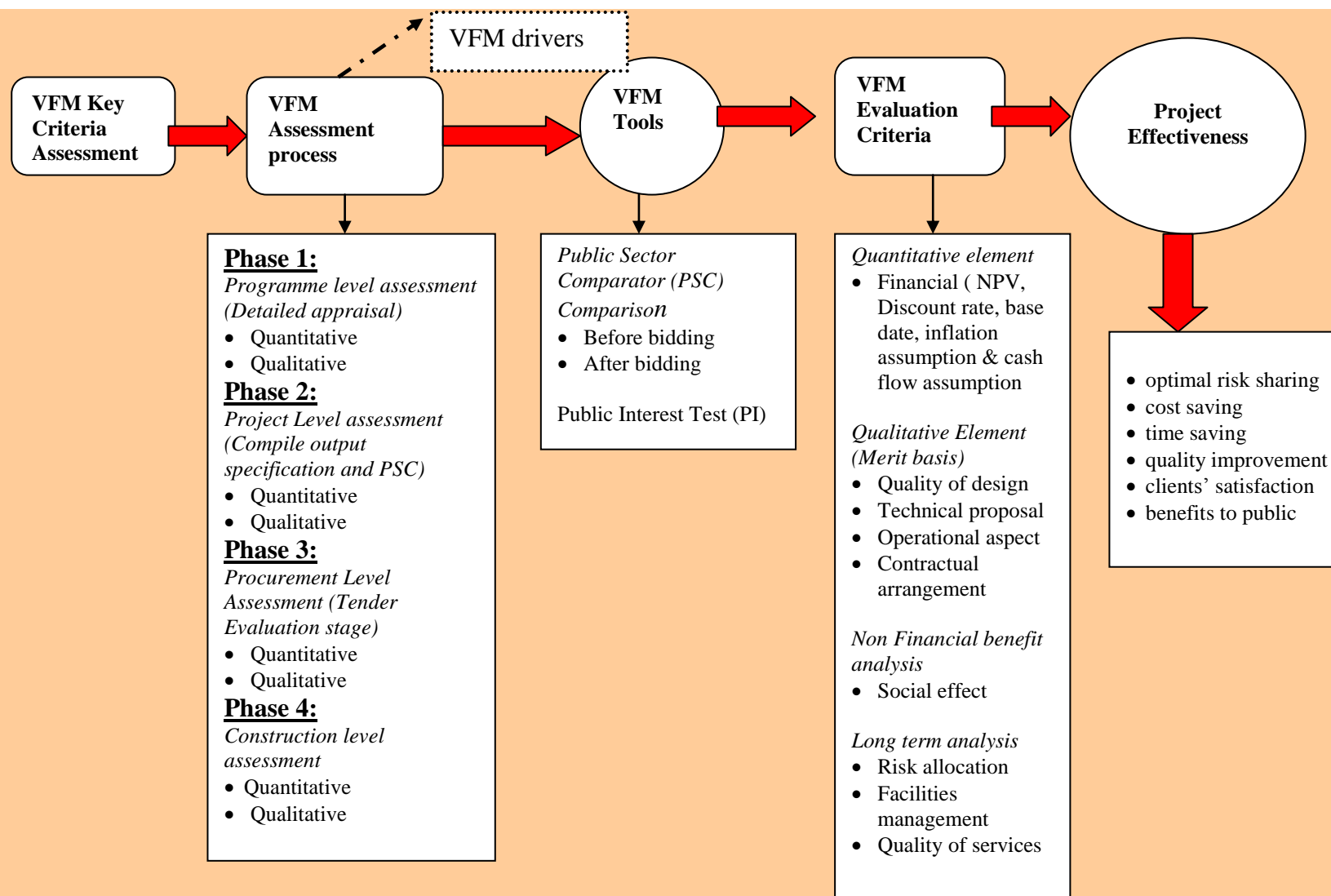


Figure 1: A conceptual framework of VFM assessment for PFI projects across project phases

7. Conclusion

This paper attempts to review, synthesize and develop a framework of VFM assessment for PFI projects in Malaysia based on the notions of VFM assessment models from the UK, Australia and Japan. It also attempts to investigate the components of PSC as a tool to evaluate VFM. It appears that the majority of the countries are using PSC mechanism as VFM assessment tool in procurement, evaluation and quantification risks. However, there is no one best way of establishing VFM for the fact that assessment of VFM in a PFI contract is usually hindered by the lack of transparency and public accountability in the processes. Therefore, it is imperative for the Malaysian Government to establish a PSC guideline in the evaluation of VFM for PFI projects at various project phases. Due to high social obligation placed on PFI projects in Malaysia, the proposed framework of VFM assessment for PFI in Malaysia also includes non-financial benefit analysis as integral components of the VFM evaluation criteria.

The research presented in this paper is part of an ongoing PhD research at the Faculty of Architecture, Planning and Surveying, UiTM to develop a framework of VFM assessment for PPP projects. The results of the study would provide an insight into the Malaysian construction project development and forms the basis of a valuable guideline, especially to public and private sectors in Malaysia.

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