

# SUSTAINABLE PROCUREMENT: A CONTEMPORARY VIEW ON AUSTRALIAN PUBLIC PRIVATE PARTNERSHIPS (PPPs)

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## ABSTRACT

The last two decades have seen the evolution of Public Private Partnerships (PPPs) as an alternative procurement method to traditional methods of delivering public infrastructure. Gaining significant popularity in the UK during the 1990's PPPs have gradually spread worldwide to become an accepted approach to infrastructure provision. In Australia, there would appear to be considerable growth potential for PPPs given that both the New South Wales and Victorian State Governments have recently developed policies to expand the application of PPPs to include social infrastructure, such as hospitals and schools. This growth potential has led to an ongoing debate on the nature of the bid requirements for social infrastructure PPPs, particularly in terms of the cost of bid preparation.

This paper maps the historical development of PPPs in Australia and describes a recently commenced research project which is investigating current approaches to the identification and allocation of risks during the bidding process of social PPPs with particular reference to the legal and financial (i.e. transaction) aspects. The primary objective of this research is to improve the process of risk identification and risk allocation for Public and Private Sector stakeholders in PPP bidding with the ultimate goal of minimising the transaction costs of the bidding process.

**Key words:** Public private partnership; economic infrastructure; social infrastructure; risk allocation; success factors; complexity index

## 1. INTRODUCTION

This paper describes a research project that is primarily concerned with the transaction costs of bidding for Public Private Partnership projects, particularly in terms of the process of risk identification and risk allocation. The research project is based on the *a priori* assumption that PPPs are integral part of the Australian procurement landscape to the extent that, to quote Duffield (2005 p. 5), "The Australian PPP industry can now be defined to be in its second generation of the modern era". This is not to say that PPPs are not highly contentious nor without their critics. For example, the recent publicity relating to the Cross City Tunnel in Sydney (Farrelly 2005; Mitchell 2005; Salusinszky 2006; Scott 2006) demonstrates the political risks involved when a high profile PPP incurs the public's ire. Additionally Curnow et al (2005 pp. 39-42) have argued that the current costs of bidding for social PPP projects

(as opposed to economic PPP projects) are unsustainable and that this is a critical issue which, if unresolved, will deter companies from entering into the PPP bidding process, particularly in terms of social projects such as schools and hospitals. Moreover at a very fundamental level some commentators such as Sheil (2003 p. 5) have raised ideological issues with the manner in which PPPs have been deployed in Australia and several writers including Sheil (2003), Davis (2005) and Spoephr *et al.* (2002) subscribe to the view that the use of the term Public Private Partnership is a deliberate attempt to mislead the public into accepting what is, in effect, privatization by stealth.

Whilst, as stated, this paper is primarily concerned with research which has the goal of minimizing the non-value added activities associated with the PPP bidding process, is useful to place this research in a historical context and also to make reference to the strong views currently being expressed in Australia by protagonists against PPPs.

## **2. PPPS: IDEOLOGICAL OBJECTIONS**

As Hodge and Greve (2005) discuss in their introduction to ‘The Challenge of Public-Private Partnerships’ very large commitments are being made by governments with the private sector under the aegis PPPs. In Australia this will have amounted to 20 billion AUD from the period of 2003 to 2008. (Gray 2002; cited in Hodge and Greve 2005 p. 3). As may be expected, this scale of ‘contracting out’ has added considerable fuel to the emotive ‘public versus private debate’. This debate is universal and has been going on from the time of Adam Smith’s ‘The Wealth of Nations’(1776). Australia with a much shorter historical exposure to institutional arrangements between governments and the private sector than say the UK has been, perhaps because of this reason, the source of some of the most recent vitriolic criticism of PPPs. Sheil (2003) is of the view that PPPs represent not simply privatization by stealth but “privatization plus stealth”. Quiggin (2004 p. 1) presents a similar, if less forceful case in stating that “In most cases the PPP approach involves an inappropriate allocation of risk between the public and private sectors, an excessive cost of capital, and an inappropriate bundling of risk through the use of a single private partner (or consortium) rather than separate contracting for separate contracting for separate project stages. And expresses the view that “...the PFI/PPP approach should be adopted only in special cases.”

Trenchant criticism of PPPs is not restricted to Australian commentators. For example Crouch (2003 p.2) presents the argument that “...corporations that are winning the contracts do not themselves have the experience of providing the services. Their core business is winning public contracts across a range of sectors”. This is a recurring theme amongst critics of the PPP approach namely that the major private sector players’ expertise lies primarily in the organization and winning of tender bids rather than undertaking the work.

The ‘language’ of PPPs is also a point of issue with its critics. Sheil (2003 p. 1), for example, cites Orwell’s essay on Politics and the English Language in support of his proposition that political decay is connected with the decay of the language. The particular point at issue being the use, or from Sheil’s point of view, the misuse of the word ‘partnership’ in PPPs and whether in fact the term ‘Public Private Partnerships’

has any meaning. In Sheil’s view the slack usage of the PPP term by state governments is a deliberate attempt to obfuscate the real issues. Hodge and Greve (2005 p. 7), although by no means ‘anti-PPP’ cite Linder (1999) in describing PPPs as a ‘grammar of multiple meanings’ in which “The language of PPPs... is a game designed to ‘cloud’ other strategies and purposes.”

Notwithstanding the above quite fundamental objections to PPPs the balance of opinion would appear to be that PPPs are here to stay and are deeply embedded as part and parcel of government procurement strategies. In our view, accepting that PPPs are part of the contemporary procurement landscape is not an unreasonable position.

### 3. PPPS: AUSTRALIAN ORIGINS

It would appear that most Australian commentators such as Jones (2003), Duffield (2005), Malone (2005) Walker (2003), Jordan and Stillwell (2004) and Evans & Bowman (2005) subscribe to the view that PPPs are a natural progression from Build Own and Operate (BOO) contracts such as the Gateway Motorway and Bridge, Brisbane (BOO completed 1986) and Build Own Operate and Transfer contracts such as the Sydney Harbour Tunnel (BOOT completed 1992). Duffield (2005) has classified Australian PPPs into ‘first’ and ‘second’ generation with the release of the Victorian Government policy document ‘Partnerships Victoria’ in 2001 being the watershed between the 2 generations. Duffield contends that the first generation of PPPs was primarily motivated by the public sector gaining access to private capital and the transfer of near full project risks whereas in the second generation of PPPs state governments sought to retain direct control of ‘core services’ and to involve the private sector in amongst other things, value for money outcomes (Yates and Sashegyi 2001).

Table 1 is our summation of key events in the development of PPPs in Australia from the 1980’s onwards and illustrates the first and the second generation divide.

**Table 1: Key Events & Initiatives in the Development of PPPs in Australia**

1980’s	1990’s 1ST GENERATION OF PPP’S	2001 to date 2ND GENERATION PPP’S
<p><b>1980’s</b> Pressure due to poor balance of trades, excessive high debt, government borrowing limit capped by loans council, poor fiscal management - Aust. Gov. seeks alternative methods for development without further reducing credit ratings</p>	<p><b>1990’s</b> Victoria gives lead with privatisation, outsourcing and BOO &amp; BOOT Projects</p>	<p><b>2001:</b> PPP manual ‘Partnerships Victoria’ released. Queensland ‘Public Private Partnership (PPP) Policy’ released in September 2001</p>
<p><b>1980-90’s</b> Australia governments embrace economic liberalism in order to improve efficiencies</p>	<p><b>1996:</b> National Competition Policy, supported by Competition Principles Agreement endorsed by all Australian governments.</p>	<p><b>2002:</b> NSW Government publishes a ‘State Infrastructure Strategic Plan’; SA Government releases PPP Policy &amp; establish PPP Unit in Treasury. WA releases ‘Partnerships for Growth’ was released as the Policies and Guidelines for Public Private Partnerships</p>

<p><b>1983:</b> Australian dollar floated on international money markets - first step to deregulating the national economy</p>	<p><b>1990's</b> Corporate liberalism emerges in government. An ideological shift towards government playing more of a managerial role. A number of privatizations &amp; outsourcing take place across Australia.</p>	<p><b>2002:</b> Intergenerational report released with the Budget papers (Treasury 2002) warned that net government spending will need to rise by 5% of GDP by 2041-42 to fund the same standard of services &amp; level of benefits.</p>
<p><b>1987:</b> NY stock market crash - ripple effect in Aust. ends the speculation boom that had followed the deregulation of the economy.</p>	<p><b>2000:</b> Airport Link Company collapses six months after Sydney's airport rail link is opened, becoming one of Australia's first PPP projects to fail.</p>	<p><b>2003:</b> National PPP Forum held; Victoria 'Fitzgerald' review; NSW 'Parry Inquiry' recommends public debt used only when all other funding options have been fully explored.</p>
<p><b>1988:</b> NSW first documented formal procedures &amp; controls governing private sector participation.</p>	<p><b>2000:</b> TAS. Government releases a policy statement, and guidelines, on private sector participation in the provision of public infrastructure</p>	<p><b>2005:</b> Local Governments propose to use PPP model for a number of urban revitalisation projects, such as Parramatta, Liverpool in NSW.</p>
		<p><b>2006:</b> NSW Parliamentary Inquiry into Cross City Tunnel &amp; PPPs. NSW &amp; Victoria announce continued use of PPPs as well as increase use of public debt to meet infrastructure shortfall.</p>

## 4. RESEARCH APPROACH

### Context

As part of this research a compilation was made of all PPP projects<sup>1</sup> from 1986 onwards undertaken to date in Australia. This compilation included all projects listed by Jones and Duffield together with (as far as is known) all PPP projects up to the May 2006. The data indicates (with a few exceptions) that the application of the PPP approach to hard social infrastructure PPPs is a relatively recent trend but one which is gathering momentum with many of the projects currently under consideration or in the pipeline in 2006 being for hard social PPP projects. Whether or not these projects progress to fruition will largely depend on the perceived risks and returns to the private sector. In this respect the research that we are undertaking is highly apposite.

### Cost of bidding and bid price

Our research addresses two quite distinct questions. The first question is whether the cost-to-bid ratio is higher for social PPPs than economic PPPs and, if so, does this act as a deterrent to potential bidders? The second question addresses the issue of how bidders for social PPPs identify risks, opportunities/success factors and how these are built into the bid price. It is important to distinguish between the two questions as problems can and do arise when the cost of bidding is confused with the bid price. There are difficult methodological issues associated with both questions.

<sup>1</sup> Argy *et al* (1999; cited in Grimsey and Lewis 2004 pp. 20-21) make the following useful distinctions between types of PPPs:

- hard economic infrastructure e.g. roads
- soft economic infrastructure e.g. financial institutions
- hard social infrastructure e.g. hospitals
- soft social infrastructure e.g. social security

## **The Cost of Bidding**

Hughes et al (2006) describing a study on the cost of procurement in the construction industry, makes the statement that there is a “desperate need for robust data” in respect to tendering costs. Whilst it may appear to be a relatively straightforward matter to identify the costs of bidding for a specific project, in reality this is not the case. “Complexity of the data collection places significant hurdles in the way of those who wish to undertake research in this area. This is probably why so few attempts have been made at assessing these costs. The quantification of the costs of tendering that have already been reported in the literature tend to focus on the cost of estimating and bidding, and take no account of the relationship between the distinct stages of a project. Moreover, they are based on impressionistic estimates, rather than analysis of data. However, the fact that they range from 1% to 15% indicates a strong feeling that there is a lot of expenditure in this area, and it is difficult to quantify. Also there is the further conclusion that the value added by this expenditure is not clear” (Hughes et al, 2006). The authors comment on ‘impressionistic estimates’ is particularly interesting in the context of PPP bidding. Our own research is still at the data collection stage and the data has yet to be finalized and analysed. However we are beginning to appreciate the aptness of their term ‘impressionistic estimating’. In addition to the difficulties associated in accurately allocating costs to a specific tender bid there is the added dimension of the commercially sensitive nature of the data surrounding PPP bidding and also the extended nature of the commercial relationships of a PPP consortium.

## **Bid Price**

As previously discussed one of the primary objectives of this research is to explore how PPP consortiums allocate the costs of risks, opportunities and success factors in their bid price. Whilst a good deal of research has been conducted in the risk management field in terms of the risk measurement/ risk analysis part of the process, it would appear that often there is a mismatch between theory and practice. A survey of 123 respondent Australian companies and organisations by Yates and Sashegyi (2001) found that for many large projects:

- formal risk assessments were not undertaken,
- risks were not being allocated to the party best able to manage the risk,
- risk clauses were often varied from those in the standard form of contract,
- risks were being transferred to consultants and contractors which were impossible for them to manage,
- cost saving would have occurred if risks had been more efficiently allocated, and
- contractors, consultants and principals have widely different views on current risk allocation (procedures).

Whilst the above findings are not specific to PPPs they are generally indicative of the problems of risk allocation in major project and certainly come to the fore when a project fails to live up to stakeholder expectations.

Bowen and Edwards (2005) note that the prevailing view of risk as a negative concept is under challenge and describe an emerging school of thought in the form of ‘opportunity management’ where “one person’s risk may be another’s opportunity to profit”. However Bowen and Edwards also note that whilst the notion of opportunity being the converse of risk is laudable, most risk management publications (including

their own text) dwell on the aspects of risk as viewed in a negative rather than a positive context. Bowen and Edwards explain that “in opportunity management, the probability attaches not to the occurrence of a particular event leading to a consequence, but to the attainment of a particular outcome if a particular decision is made.” From a methodological point of view attempting to undertake a forensic investigation of the consequences of a particular set of decisions is fraught with difficulty. However being able to identify specific factors which correlate to the project outcomes is a more achievable objective. For this, and other reasons we have determined to examine the positive aspects of risk through critical success factors.

### **Critical Success Factors**

The concept of ‘Critical Success Factors’ (CSF) was developed by Rockart and the Sloan School of Management with the phrase first used in the context of information systems and project management (Rockart 1982). Morledge and Owen (1999) further developed the concept of CSF by identifying certain weaknesses associated with the practical application of Rockart’s method. They identified and attempted to address the perceived areas of weakness such as: subjectivity; bias; human inability to process complex information; time dependency; generalisation; and qualitative performance measures.

Research into CSF has been on-going for several decades although Sanvido *et al* (1992) maintain that the CSF approach has been largely ignored by the construction industry and establishing the factors that make construction projects successful has been particularly intractable. Recent research tends to take a relationship-based approach to the issue of CSF. For instance, Rowlinson (1999) states that critical success factors are those fundamental issues inherent in a project that must be maintained in order for team-working to take place in an efficient and effective manner. They require day-to-day attention and operate throughout the life of the project.

A number of authors have identified factors they consider critical to the success of project procurement under PPP or similar concepts. Table 2 lists the CSF factors for PPPs with author citation.

**Table 2: CSF factors for PPPs with Author Citation**

<b>CSF</b>	<b>Citation</b>
Appropriate and developed legal framework	Tiong (1995)
Financial capability and support	Tiong <i>et al</i> (1992)
Appropriate risk allocation	Grant (1996)
Political stability and support	Keong <i>et al</i> (1997)
Expertise	Salzmann and Mohamed (1999)
Local partner/s	Salzmann and Mohamed (1999)
Transparency	Jefferies <i>et al</i> (2002)
Appetite for competition	Jefferies (2003)
Tender cost reimbursement for losing contractors	Jefferies (2003)
Commitment	Hardcastle <i>et al</i> (2005)
Developing a culture of partnership	Duffield (2005)

Success within the context of a PPP will mean different things to different stakeholders. They will have some common goals but will also have several project and long-term aims that are very different. We believe that this critical assessment is best dealt with through the use Critical Success Factor concept and, as previously stated, this is the methodology that we intend deploying in our research approach.

## **5. PRELIMINARY FINDINGS**

The following initial findings were identified during the first round of data collection, i.e. workshops and interviews with key stakeholders in the PPP bidding process. This initial stage helped to identify the characteristics of social PPP projects in Australia and also map the development of these projects. These findings provide the foundations for the remainder of data collection and in particular the identification of CSF.

### **Characteristics of Social PPP Projects**

Respondents generally agreed that hard social infrastructure projects (schools, hospitals) are characterised as being smaller in scale than economic infrastructure projects (motorways, bridges, tunnels etc.) and, by their very nature, also tend to be complex, particularly in terms of ongoing involvement with the community. Thus private sector bidders for social infrastructure PPP projects are often presented with a situation where the financial rewards are less and the operational demands are more complex than for economic PPP projects.

This round of data collection also identified that there is a strong body of opinion to support the contention that current social infrastructure projects in Australia are not true partnerships and there is a clear need to reduce the ‘tokenism’ of Australian PPPs. Interview participants put forward the view that the Public Sector needs to make PPPs more attractive to the Private Sector and clarify the identification of risk in order to transfer more responsibility to the Private Sector. This issue is supported by other recent industry criticism of PPPs concerning the ‘narrowness’ of the scope of work that is offered to the private sector.

PPP project costs relating to finance, building design, construction, maintenance and waste management amount to less than 15% of the total life cycle cost of the enterprise. As a result, the private sector may be deterred by the high transaction costs of PPPs, which offer only a marginal increase in scope of business opportunity. This is in stark contrast to opportunities that are available in the much lower cost-to-bid ratio of more traditional procurement models or in hard economic PPP projects where the revenue stream from, say, a freeway toll way has a substantial and clearly defined internal rate of return. Governments are looking for significant increases in efficiency through the PPP process, but no matter how well the 15% of the enterprise available to the private sector is organised, it is not going to make up for inefficient management in the remaining 85%. We have also received comments that support the view that a number of major construction contractors are either withdrawing from social PPP projects completely or are being highly selective due to the unattractiveness of the projects on offer.

## **6. CONCLUSIONS**

As previously stated this paper is based on a research project which is still at a preliminary stage. Whilst the theoretical underpinning has been established, data collection is proving to be difficult, although not insurmountable. This is partly due to the commercially and politically sensitive nature of the data. Additionally the paper trail involved in tracking data is extensive. A PPP consortium is a temporary

organisation with a complex network of players with competing goals and objectives, many of whom never get to see the complete picture. Inevitably the group operates under pressure, particularly the members of the SPV (Special Project Vehicle) who are the drivers of the bidding process. The private sector view which has been continuously reinforced in our workshop sessions is that social, as oppose to economic PPPs, are more complex with relatively higher bid costs. Another recurring theme has been the difficulty in developing a true partnership between the public and the private sector in bidding environments which are frequently adversarial. In an ideal situation 'success' would result in win-win situation with a successful outcome for all the stakeholders, whereas all too often success is regarded as victory for the public sector over the private sector or vice versa.

It is our view much of the negativity and adversarial environment which surrounds PPPs is due to a lack of transparency both in terms of the costs of bidding and in terms of identification of risk, opportunity and success factors. This research which will track, for the first time (at least at any rate in Australia), the transaction costs of bidding together with CSF and should assist, at least in part, in providing a better understanding between stakeholders in the PPP process.

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