



## 11. Private sector potential to assist with municipal infrastructure o&m

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### ABSTRACT

The paper discusses the potential of the private sector to operate and maintain infrastructure owned by municipalities.

The “private sector” ranges from large South African companies, right down to emergent microentrepreneurs. It has widely ranging interests and capacity. It is willing to assist in favorable conditions.

The paper outlines what the private sector could offer. It then discusses the business environment: including procedures, procurement, transparency, sharing of risks, the need for competent clients, fair contracts that are equally binding. The constraints and how they could be overcome are also discussed.

Given the lack of capacity in local government, it would be self-defeating for municipalities not to partner with the private sector where practical, and knowing that there will be clear roles and mandates, astute management of tensions, and compelling incentives to play by the rules.

### WHY THIS DISCUSSION IS NEEDED

In a wide ranging document on The State of Local government in South Africa, the Department of Co-Operative Governance and Traditional Affairs writes “Local government in South Africa has contributed to the achievement of a number of significant social and economic development advances, since the ushering in of the new democratic municipal dispensation in December 2000. The majority of our people have increased access to a wide range of basic services and more opportunities have been created for their participation in the economy. [However] notwithstanding the valuable role that municipalities have played in our new democracy, key elements of the local government system are showing signs of distress.” (CoGTA 2009, p3)

Prominent among the “priority areas” causing the problem is “insufficient municipal capacity due to lack of scarce skills”, despite “... national government [having] allocated hugely significant sums of money to building capacity over the years. In seeking to answer the question why outcomes have been so disappointing, it is clear government needs to begin to do things differently”. (Ibid, pages 4 and 5)

In the chapter “service delivery and infrastructure”, the report places most of the emphasis on “clearing backlogs” by providing infrastructure to those that don’t have, the need for increased and more competent operation and maintenance of infrastructure comes across clearly. It is also referred to in CoGTA’s follow-up report on the “turn-around strategy”. (CoGTA 2010)

Disappointingly, however, neither report makes specific mention of the private sector as a potential resource. A scan of the 2010 report could not locate the words “private” or “outsource”.

Yet, the Minister of Finance can say:

“Why is it that a soft drink company can deliver soft drinks to its thousands of outlets on time and without any leakage, and yet our clinics are without drugs and medicines, and learner support materials arrive late or never arrive at schools?” (Ministry of Finance 2009)

And:

“Many municipalities are hampered by lack of flexibility in existing

internal arrangements to deliver services and continued pressure on available human, financial and physical resources. Municipal service partnerships (MSPs) can allow a municipality to concentrate resources and management attention on its strategic core activities of planning and managing services within its municipality without having to be involved in the actual mechanics of service delivery.” (DPLG 2006, page 4)

This paper explores the potential of the private sector to resolve many of the problems that municipalities periodically encounter in planning, maintaining and operating services.

There is no reason for municipalities to believe that contracting with the private sector is an acknowledgement of failure. There is always a limit to resources and manpower and South Africa is no exception. In writing and presenting this paper, the authors have no particular axe to grind. The interest in the subject derives from arms length observations and a desire to improve the capacity of Municipalities to deliver on their responsibilities.

### HOW CAN SERVICES BE EFFECTIVELY DELIVERED?

The Constitution is clear on where the roles and responsibilities to own, operate and maintain public services lie. Nevertheless legislation permits considerable flexibility when it comes to who should operate and maintain those services. For example, Water Services Authorities have responsibility for service delivery, but can use Water Services Operators as their agents. In practice, using the private sector to operate and maintain infrastructure can overcome some serious issues including the skills shortage. Surely, if the “end justifies the means”, and the responsibility for the well managed delivery and ownership remains with the municipality, the entity operating and maintaining services should depend on the answers to pragmatic questions about how best to achieve this goal. If a municipality is short of technicians would it not make sense for it to seek assistance from those who have? It is much to be preferred that strategy, planning, financing (including tariff-setting) and other key issues remain in-house, but why not outsource some of the day-to-day needs? There should be no in-principle objections – especially if the ownership and setting of user charges, levels of service, setting priorities and other policy matters remain under municipal control.

Outsourcing should be viewed as an opportunity:

- to improve facilities
- to retain income locally;
- to develop needed skills: and
- to encourage local business.

In a nutshell: the preferred institutional mode of delivery is –

- municipal ownership of infrastructure, with
- municipal operation and maintenance;

A case can be made for experimenting with municipal ownership and private sector or NGO operation and maintenance.

The MSP guideline document succinctly sets out the “rules” and also the “purpose”:

- “While MSP involves outsourcing municipal service delivery, a municipal council cannot outsource its accountability. Although MSPs change the means of delivering services, they do not change a municipality’s accountability for ensuring that the services are delivered.
- Under MSP, a municipality’s focus shifts from managing the inputs of service provision to managing the outcomes. It becomes a contract manager rather than a resource manager.” (DPLG 2006, page 3)

While this point seems superfluous, it has been observed that first-time hearers of the suggestion sometimes leap to the conclusion that indigent South Africans will now have to pay, or pay more. There is no cause for this conclusion. If people are indigent, and therefore benefit from the policy of “free basic services”, they will continue to benefit irrespective of any contract.

### WHAT “THE PRIVATE SECTOR” CAN DELIVER

“The private sector” is not homogenous, therefore the remarks in this section relate to what, at any given time and in any given circumstances, some private sector organisations could offer. Nevertheless these same organisations may not be willing to engage. Even more so, other parts of “the private sector” could not offer their services under any circumstances. To start with, a simple example: The purpose of a petrol station is to sell petrol. The manager and staff ensure that the pumps work, that the petrol is not contaminated, that the forecourt is clean, and that the storage tanks never run dry – that’s what they do. It’s no big deal for them to do this reliably, day in and day out. In contrast, some water services authorities cannot guarantee that the pumps always work, that the drinking water is not contaminated and that there is a continuous supply of the necessary chemicals.

This could be due to a number of factors, including:

- shortage of money or inappropriate allocations, inadequate technical skills, unresponsive procurement practices;
- poorly trained people with low moral;
- under-qualified managers.

How can the private sector assist? In short, it could offer the kind of resources, including management skills which enable petrol to be sold day in and day out. It has the ability to resolve the kinds of issues that hamper public sector service through its access to working capital, technical skills, procurement credit, worker incentives and management, provided always that income is at least equal to expenditure.

Experience world-wide has shown that when implemented effectively, the delegation of service delivery to a specialist service provider, MSP, can improve efficiency, customer service, competitiveness and quality, implement best practice and even reduce costs. In this way, MSPs can benefit the government’s municipal infrastructure programme.”

(DPLG 2006, page 4). For a more complex example: CSIR has recently co-operated with two organisations, one private and one public, both seeking to increase efficiency and reduce wastage. They both own and operate large fleets of vehicles that are based at depots and service many dispersed sites. A significant difference in the will, and the effort, to ensure value for money was found. In the private sector case the drive to ensure value for expenditure was strong. For example:

- Supply chain management was well planned and implemented.
- Vehicle usage was tightly controlled.
- Maintenance was carefully planned, and speedily performed by qualified staff.
- Arrival at and departure from sites was tracked.
- Vehicle and equipment purchase, operation, maintenance and replacement were governed by life cycle cost considerations.
- Accountability was strong and the incentive structure (e.g. pay, bonuses and disciplinary action) reinforced this accountability.
- Any deviations from predetermined costs, standards and so on were reported to management and ways were sought to improve future performance.

In the public sector case the drive to ensure value for expenditure was

weak, for reasons both systematic and managerial. For example:

- Supply chain management appeared to be weak or absent.
- At any one time, a large proportion of vehicles were being repaired or otherwise out of action.
- Measures to improve vehicle and equipment availability by logging maintenance cycles and using travelling mechanics to service remote sites were not evident.

Why such a strong contrast with the private sector case?

Frankly, value for expenditure did not seem to be important and there were no performance incentives. But why is there no will to deliver value for the taxpayer’s Rand?

This is not an easy question to answer because of the complexities and interactions that make up a well managed operation. In essence it requires the synthesis of many strategies. Nevertheless it is obvious that if some of the methods in common use in the private sector were diligently applied in the public sector, productivity would improve.

The key elements are vision, leadership and guidance.

These are two particularly contrasting cases but there are also many public sector organisations where value for taxpayer’s expenditure is a strong driver – and it shows in their achievements.

The private sector could offer four primary benefits:

- Flexibility: because the private sector can be contracted for a specific service over a defined time, after which the costs associated with the contract are no longer borne by the Employer. Resources no longer needed are not an ongoing expense.
- Sharing contractual risk.
- More certainty that spending will meet defined goals because the private partner would only be paid for measurable quantities and output.
- Skills: including management skills.
- Capital to sustain long term operations.
- Organisation and team work

This is only possible in an environment that includes unambiguous contract documents, competent public sector client staff, well trained operators and money to pay for the work, none of which can be taken as given

If the contract is structured correctly, and the relationship between the municipality and the contractor is one of equals (ad idem), then the risks can be equitably shared. The consequences of natural events (floods), financial events (interest rate changes), construction events (unforeseen ground conditions), and so on can be shared in accordance with the contract. The risks arising from all work being done in-house are borne by the municipality.

Measurable outputs and the consequential payment lead to:

- transparency: payments are substantiated by what is delivered;
- control of variations: these can be measured and priced;
- cost control: the consequences of undertaking more or less or different work, can be understood both before a decision is made and the costs allocated.

When work is done, extra costs can go untraced and therefore not be taken into account when decisions are taken. There is no contract document to distinguish between realities and ‘make believe’. A list of all the skills available in the private sector could fill many pages. Two advantages of this skills base are:

- It can be hired when required
- Ongoing skills management is no longer the responsibility of the municipality.



The second point is best illustrated by another example. Hiring a contractor to operate and maintain a water services system places the onus on that contractor to assemble and manage all resources. Ordering materials on time and employing qualified staff is his job and the consequences of not doing so are for his cost. When the contractor makes a mistake, and has to repeat work, the municipality does not pay more – whereas if the mistake was the municipality's, it would have to bear the cost. The municipality buys the management. The teamwork and the burden of resourcing and managing the team is transferred from the municipality to the contractor.

Outsourcing requires a knowledgeable client. A municipality's ability to monitor performance and enforce a contract is key to an effective outcome. If a municipality is short on managers it can redirect the competencies it has to manage the contracts.

### THE DIFFERENT "PRIVATE SECTORS"

The private sector has wide ranging interests and capacity. Large civil engineering contractors have a different perspective from that of emerging microentrepreneurs but they would all like to participate if conditions are favourable.

In this paper, it is only possible to outline how each could play a role in operation and maintenance. At the risk of over-simplification, the following are broad groupings that could play a role within what is generally referred to as the "private sector". That is an ongoing "hands-on" commitment, as opposed to short-term assistance and consulting:

- major civil engineering contractors;
- mid-size to "small" civil engineering contractors;
- very small to micro civil engineering contractors (with or without association with larger contractors, perhaps in the form of being managed subcontractors);
- international infrastructure operators ("international private operators", or IPOs) e.g. water services operators – large scale;
- the larger South African infrastructure operators – e.g. water services operators;
- specialist infrastructure operators – e.g. water services operators – of mid-size to "small";
- very small to micro infrastructure operators – e.g. water services operators (with or without association with larger operators, perhaps in the form of being managed subcontractors, or being in a franchise arrangement);
- consultants, of different sizes, with specialist expertise, and/or unusual entrepreneurial vision and ability;
- other private sector organisations, of different sizes, that see potential, sometimes based on a technology that they wish to offer, and that for strategic reasons they decide to offer together with some form of operation and maintenance relationship; and
- banks as a funder of infrastructure for either the capital or the operating account.

Combinations are also possible – for example Project Implementation Agents (PIAs) that operated 10 or more years ago. These included IPOs, major civil engineering contractors, and smaller partners, including NGOs. Large water users can partner with the expertise that it needs to operate, maintain or refurbish water services belonging to a third party. The improvement in the service of the third party can make life easier for the bulk supplier. There are already a few instances in South Africa where a major water user assists a local municipality

to treat water and wastewater for its customers. This is sometimes a corporate social responsibility, but can also be in the interest of the supplier who would rather have its water sources uncontaminated, than polluted by a dysfunctional wastewater treatment works.

Contractors with trained staff who expect a downturn in new construction, could have considerable resources available.

While their staff have experience of building and not generally operation and maintenance they do have the basic skills and experience and can readily be retrained. An understanding of the various contributions that can be expected from the private sector is useful. The bottom line, however, is that the private sector has significant capacity to assist municipalities to operate and maintain their infrastructure.

### THE ENVIRONMENT

The environment must be conducive to any partnership including:

- Procurement rules and procedures must be unambiguous and applied fairly and transparently.
- Time needed to approve contracts is not protracted, and the outcomes are predictable and consistent.
- Risks are reasonably shared between the parties in general conditions of contract.
- The client is knowledgeable and able to plan and budget for the work done, and to call for proposals. The client must also be able to:
  - interact with the contractor in a knowledgeable way (e.g. that the contractor's questions on technical issues can be debated with the client as a discussion between equals);
  - make firm and fair decisions without unreasonable delay; and
  - generate sufficient cash flow to sustain payments throughout the contract period and avoid termination outside the contract rules.
- If contractors do not perceive a contract to be fair, they will either load their tenders to compensate for the risk or they will not tender at all.

### CONSTRAINTS TO OUTSOURCING

The four issues below are those most frequently raised as constraints to the private sector operating and maintaining infrastructure:

- Money not available.
- Municipalities not honouring their contracted obligations.
- Union resistance.
- Procurement – in particular meeting the Section 78 procedures in the Municipal Systems Act (South Africa 2000).

To elaborate:

The financial affairs of many municipalities are not in order and are unable to recover revenues due to them. Financial constraints lead to inadequate and inappropriate operating and maintenance.

This is exacerbated by the tendency of municipalities to reallocate funds earmarked for maintenance to other activities during a financial year. Inability to process accounts and pay invoices on time is much in evidence. This does not bode well for the private sector.

Furthermore, inability to pay invoices on time creates considerable difficulties when outsourcing even to a larger contractor.

It would very likely be fatal to SMMEs, which have few reserves and might be dependent on a few clients or even on one client. There are indications that some unions will resist the outsourcing of municipal services for fear that it could lead to the retrenchment of their members.

## ON PROCUREMENT

There appears to be nothing in DWA, COGTA and National Treasury policy, legislation or regulations preventing outsourcing of services. Public-public partnerships, public-private partnerships, or a partnership with an NGO or community-based organisation (CBO) are permitted. Outsourcing and procurement legislation only governs procurement from the private sector. The rules relating to feasibility studies etc do not all apply when sourcing services from the public sector. The National Treasury and COGTA legislation and regulations control the need for transparent and equitable procurement and include anti-corruption measures, such as sequential approval and for evaluation and adjudication committees, etc. Councillors are barred from membership of certain committees. When considering outsourcing, Section 78 guidelines must be followed. However, if a municipality is not considering outsourcing, it does not have to demonstrate that it can provide acceptable services. Thus in practice too few municipalities go to the trouble of seriously considering alternatives to in-house operation and maintenance. Municipalities should be encouraged to follow Section 78 processes and determine to what extent they are best able to operate and maintain with their own establishment and thereafter to assess the extent that outsource could enhance delivery. Without exploring alternatives objectively, municipalities may have no reliable financial or an information-supported rationale for the decisions they need to take in the interests of satisfying their customers. At very least, municipalities should assess the real costs of 'do it yourself' to make true comparisons. Municipalities who do not have the capacity or systems to analyse their operating costs are unlikely to be able to manage their responsibilities effectively.

## OVERCOMING CONSTRAINTS

Municipalities should be supported in their efforts to contract with the private sector. Support can be from people or organizations and include drawing up procedures, protocols and documents. There are several ways in which this is commonly done in South Africa. For example schemes to deploy experienced (sometimes retired) personnel to train and mentor staff is well established. While the purpose of these deployments has been to provide general assistance, they could be expanded to advise on outsourcing. Public-public partnerships can be restructured to achieve the same purpose; for example, when a municipality or a water board assists a local municipality on a project, or even with ongoing programmes. A water board in KwaZulu-Natal helped to roll out community water supplies and sanitation. Partnerships could supplement contract inspection and administration by an Engineer. Drafting procedures, protocols and documents are also well suited to experienced engineers who are skilled in this aspect of management. Other examples are:

- Identifying the benefits of outsourcing;
- Guiding the call and evaluation of proposals;
- Developing a standard protocol for response to Section 78.

The public sector is familiar with outsourcing infrastructure "projects", but it is less familiar with the concept of outsourcing a "service" because documents for a service contract are less well developed. For example: how do you evaluate performance of a contract to inspect and monitor bridges and culverts?

Contract deliverables need to be measurable (e.g. lengths of pipe laid to specification, man-hours of training). They also need to be unambiguous

and to measure the right things – that is, they need to reflect the desired outcomes of the operation and maintenance. To illustrate: if the desired outcome is reliability of water supply, then we should measure how much of a 24-hour day the supply is present, within defined envelopes of pressures, quality, and so on. It is possible that the most suitable deliverable could be an absence of something, rather than a presence – e.g. absence of potholes, or of trash on the streets, or of interruptions to supply. Properly drafted contract documents will avoid the dangers that can lie in a mix of different types of deliverables – e.g. a mix of infrastructure deliverables (pipes laid to specification) and welfare or economic deliverables (for example, job creation). They will also avoid "unclear demarcation between where the activities of the municipality and the activities of the MSP service provider begin or end." (DPLG 2006, page 15)

Model contracts, or model clauses for specific situations, need to be developed for a range of options.

There is a variety of interests and capacities within "the private sector" and contracts must be tailored to accommodate this variety. For example, ingenuity would need to be exercised to use the potential of small contractors being used on small maintenance contracts.

We suggest:

- simple contract documents – less than 10 pages;
- specifications expressed not in pages of text, but in terms of samples that can be inspected before contract commitment, and that can be referred to during the course of a contract;
- providing for payment at frequent intervals rather than against monthly certificates.

"Operation" and "maintenance" are not the same, and the assistance required is considerably different. For example:

- Operation could be a 24/7 activity – alternatively, it could be an activity requiring 24/7 monitoring. Maintenance, on the other hand, is periodic – that is, it is done at intervals determined by operational requirements.
- A municipality might regard operation as more strategic, and there could be sensitivities around outsourcing, whereas these same sensitivities would not apply to maintenance of the same infrastructure.

Final words on procurement from the Department of Local government

- "No matter how well the procurement process is conducted, it cannot ensure a satisfactory outcome unless the project itself has been properly identified and benchmarked against existing service delivery performance.
- Similarly, no matter how well structured the MSP contract (or service agreement) might be, a sound contract on its own will not make up for deficiencies in the procurement process.
- A sound procurement process will be one that has achieved value for money for the municipality and its residents." (DPLG 2006, pages 107-108)

Lastly, one or other of the parties – public sector or private sector – must accept responsibility for integration and team work, for ensuring that no part of the service delivery chain falls between the cracks.

For example it might be cost-effective to contract the routine maintenance of a network's gravel roads to a number of small road construction companies; it might be as well to offer them (at a price) the facility of a roving vehicle maintenance team, so as to ensure minimum downtime of their equipment.

## COGTA DOCUMENT ON MOBILISING THE PRIVATE SECTOR

This paper had largely been drafted when the CoGTA "Framework for





mobilising private sector companies ....” appeared (CoGTA 2010a). It shows a refreshing openness to new ideas and recognises that we cannot carry on in the same way and that new approaches are needed – approaches that bring in the private sector and parastatals such as water boards. The diagnosis of the problem has been well done. It is also pleasing to note the emphasis on life cycle costing and the need for ring fencing. However, it needs much more work on, among other things – the extent to which procurement (not just procurement regulations, but the way in which they are applied) inhibits involvement of the private sector;

- the faith placed in the private sector bringing funding (maybe it will – but, firstly, that is not where its main contribution could be, and, second, the private sector is not going to invest capital without substantial guarantees);
- the use of words such as “partnership” and “memorandum of understanding” (up to a point yes, but the private sector is actually wanting contracts – with defined budgets and deliverables);
- there is no mention of incentives (a range of types of which are needed);

## CONCLUSION

*“What I cannot understand I cannot build” Richard Feynman [Lectures in Physics 1962]*

The institutional model commonly used to operate and maintain public services relies on a municipality’s own resources. This approach is not intrinsically flawed. The reason why it is not always satisfactory lies in implementation rather than in the model itself. Private sector participation might not, even on paper, be ideal, but it might offer the prospect of improved services because it is able to build.

Given the deplorable state of public assets, municipalities need to keep an open mind and to seriously consider the options for improvement. This would require clear roles and mandates, competent design of contracts, and competent supervision and administration of these contracts.

Three main priorities need to be addressed simultaneously when considering outsourcing. These apply in most circumstances

- Ensure that the necessary steps are taken to allow the private, NGO and CBO sectors to compete on even terms with in-house providers. This must be done where in-house operation and maintenance is not keeping abreast of needs.
- Carefully allocate budgets to where they will generate the most long term benefit.
- Ensure that a number of private sector participation programmes are up and running as soon as possible, and that through their success they demonstrate the potential of this approach.

National government is the key to addressing the first two issues.

It is unlikely that Municipalities will want to change anything in priority No 1. National Government needs to take the leadership to effect change. CoGTA is the logical champion for the task.

Many municipalities are able to bring about significant changes to the second of these priorities on their own.

Once again leadership must fall to central government. A commitment to the needed change is noticeable, but much more needs to be done. Municipalities vary to such an extent that the challenges they face defy any one-size-fits-all solution. Nonetheless, it is unlikely that the private sector cannot assist every municipality in some or other way. Especially given the capacity in local government, it would be self-defeating not to partner with the private sector with the comfort (for both

parties) of clear roles and mandates, astute management of tensions, and compelling incentives to play by the rules. Similarly, ways must be found to tap into the considerable and varied resources available in the private sector to improve the lives of South Africans.

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