

Serving the Community
By Using the Private Sector
Policy and Practice

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EFFICIENCY UNIT VISION AND MISSION

Vision Statement

To be the preferred consulting partner for all government bureaux and departments and to advance the delivery of world-class public services to the people of Hong Kong.

Mission Statement

To provide strategic and implementable solutions to all our clients as they seek to deliver people-based government services. We do this by combining our extensive understanding of policies, our specialised knowledge and our broad contacts and linkages throughout the Government and the private sector. In doing this, we join our clients in contributing to the advancement of the community while also providing a fulfilling career for all members of our team.

Other Efficiency Unit Documents

The Efficiency Unit (EU) has produced a number of detailed guides including on outsourcing and Public Private Partnerships (PPPs). These may be found on the EU website at www.eu.gov.hk.

Throughout this document the term department is used to describe all government agencies.

FOREWORD



In recent years Hong Kong has faced unprecedented difficulties leading to fiscal deficits, budget cuts for government departments and staff recruitment freezes. Simultaneously, departments faced calls from the community for new and expanded services. Many found at least part of the solution to their difficulties was to make better use of the private sector, sometimes for the first time.

This experience has not always been easy. Sometimes the outsourcing experience was not successful. At times, we have faced accusations that the Government was colluding with business. We have learned that we must not only conduct our dealings with the private sector with integrity and impartiality, but we must also ensure that we are seen to do so. There have also been claims that outsourcing has inherent deficiencies leading to exploitation of non-skilled workers and poor working conditions. We must take care to ensure that the non-skilled, who are particularly susceptible to exploitation, are adequately protected. Notwithstanding these challenges, the experience overall has been positive. Releasing suitable services to the private sector provides opportunities for business development, wealth creation and jobs growth in ways that are simply unattainable in the public sector. Departments have found that the private sector can help them provide services to the public often at lower cost and with better quality than they could do themselves.

The economy has now recovered and the pressure on budgets and staff numbers is easing. Nonetheless, we should continue to build on the experience and expertise we have developed over the past few years. We must take every opportunity to benefit from private sector skills, innovation and flexibility to provide more and better services to the public. We should undertake in-house only those things that the private sector cannot do, or that must be done by civil servants.

This booklet updates and restates the Government's policies and practices on how best to make good use of the private sector in our quest to serve the community. I urge you to seize the opportunities that exist.

Rafael S.Y. HUI
Chief Secretary for Administration

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SERVING THE COMMUNITY ...USING THE PRIVATE SECTOR

The Government's Goal

To meet community needs in the most efficient and effective manner, by adopting, where appropriate, private sector processes and optimising private sector involvement in the delivery of government services to the community.

The Purpose of this Booklet

To provide guidance to departments on policy and the broad approach to using the private sector to deliver government services.

The Hong Kong Government's Policy

As part of the programme of continuous improvement, departments should proactively and thoroughly examine the opportunities inherent in private sector processes and capabilities. Regular consideration should be given to adopting such processes, as appropriate, and grasping opportunities to increase private sector involvement in the delivery of new and existing services. Decision makers should work on the presumption that any service to the community can in principle be delivered by the private sector, while recognising that in some circumstances public sector provision may be preferred.

PRIVATE SECTOR INVOLVEMENT IN HONG KONG'S IMPROVEMENT IN PUBLIC SERVICES

There have been a number of driving forces in Hong Kong's programme of continuous public sector reform: enhancing quality in customer services; maintaining the 'small government, big market' policy; involving the private sector in public service delivery; and adopting private sector forms of corporate structure.

Several services, such as the construction of public housing, have always relied heavily on the use of private sector resources and further private sector involvement has been woven into many reform programmes, particularly initiatives that have addressed new technologies and the enhancement of productivity.

Some public services have long been or were established from the start as government-owned corporations and, during the 1990s, other services, such as postal and business registration, were converted into trading funds.

We need to continually monitor and update our activities with respect to private sector involvement and processes to ensure that they are providing best value for money.

There is strong evidence of benefits to the community when the public and private sectors learn from and complement each other in the provision of public services. The Government has a responsibility to make the best use of both sectors to ensure that publicly funded activities do not absorb more of the gross domestic product than is optimal.

The public sector contributes positively to both the direct and indirect provision of public services. It brings:

- ◆ Experienced and dedicated staff;
- ◆ Significant public policy knowledge and skills;
- ◆ A unique source of data and intellectual property based on sound research; and
- ◆ A reputation and trustworthiness valued both within and beyond Hong Kong.

In turn, the private sector brings the disciplines of the market place and managerial effectiveness to drive efficiency. And it has:

- ◆ Experience in imaginative and creative provision of services;
- ◆ A culture of identifying and managing risks; and
- ◆ Strong awareness of expanding markets, particularly capital markets.

Efficient and effective service to the community occurs when the strengths of the two sectors come together. The taxpayers' money is then focused on achieving the highest priorities for the wealth, health and safety of the community.

The Government has a long history of involving the private sector in delivering services, particularly through outsourcing. Regular surveys of government departments using outsourcing have taken place since 2000, the latest being in July 2006. These survey results can be seen on the Efficiency Unit (EU) website at www.eu.gov.hk. Whilst there are clear indications that contracts are becoming larger and more complex and sophisticated, there are still many that are too small and short-lived to offer government and contractors the full benefits that can be achieved.

Early examples of Hong Kong's public sector reforms included the adoption of private sector corporate structures and involved the private sector in service delivery

The public and private sectors complement each other in providing services to the public - the public sector brings valuable resources and experience to the provision of services

The realities of the market exert powerful incentives and disciplines on private sector management

There are limitations in the scope and size of current contracts with the private sector

Use of private sector processes and resources should be considered first, and all departments should pursue opportunities for new arrangements

Better use of private sector processes and resources will allow the Government to use its limited resources better and focus them on identified priorities. It will also allow the economy to take greater advantage of the new opportunities that are arising in regional and global markets. It is, therefore, government policy to consider using the private sector first in undertaking new projects, unless there is compelling evidence to suggest otherwise.

To meet this policy, all departments should take direct responsibility for regularly examining their service activities to determine whether and in what manner they could be provided by the private sector. Departments should then pursue new arrangements where there is evidence to suggest that benefits will accrue. At the same time, they should seek improvements in the arrangements for and management of current private sector contracts.

ADOPTING PRIVATE SECTOR FORMS OF CORPORATE STRUCTURE

The use of private sector forms of corporate structure has played a key role in the delivery of public services in many jurisdictions. In Hong Kong, this has taken two main forms; Trading Funds and Government-owned Corporations.

Under the Trading Funds Ordinance (Cap 430) the Legislative Council (LegCo) may by resolution establish a **Trading Fund** to manage and account for the operation of a government service provided to the Government, public bodies or persons other than the Government. LegCo prescribes the services to be provided by the trading fund and the trading fund is expected to cover its expenditure by its revenue. A trading fund is an accounting arrangement that frees a department (or part of it) from the normal appropriation procedures. As a result, a trading fund often mimics the commercial behaviour of private sector organisations, particularly with respect to its relationships with its customers be they other parts of government, the business community, or the public at large. Nonetheless, a trading fund remains very much a part of the civil service, with many of the associated constraints on exploiting commercial strengths.

In some circumstances, **Corporatisation** of a public service may be necessary to achieve the twin aims of providing an effective public service and increasing the return from public assets that have a commercial value.

A corporation is established to carry out specified activities in accordance with established commercial principles. Whilst the Government is the sole or main shareholder the corporation is not part of the civil service. The corporation is generally free to manage staff and other resources in accordance with private sector principles, to explore and exploit new commercial opportunities, and to adjust fees and charges in response to market demand.

Although there are potentially many benefits to be gained from establishing a trading fund or corporatisation, departments may decide instead to use one of the private sector involvement approaches. Reasons for adopting a private sector approach may include:

- ◆ The ready availability of capable service providers in the private sector;
- ◆ The inability to recruit or retain sufficient, appropriate staff/skills within the public sector;
- ◆ The time required for the drafting and enactment of trading fund or corporatisation legislation.

In certain circumstances, adopting a private sector corporate structure and/or involving the private sector in service delivery may require that a public sector organisation be separated from or abandon its delivery role for a particular service and becoming solely a purchaser or regulator of the service in question. This may have an impact on the appropriateness of the institution's structure. Guidance on such matters can be sought from the EU.

A trading fund often mimics the behaviour of private sector organisations

Corporatisation may be necessary if service and efficiency aims are to be met

A split between provider and purchaser/regulator may be required

MAXIMISING THE USE OF PRIVATE SECTOR PROCESSES AND INVOLVEMENT

Public interest requires that best practice be adopted

More effective services for citizens and reduced costs for government may result from the adoption of private sector processes and involvement. The community will also benefit from enhanced private enterprise – the engine of economic and social growth.

Simply adopting new processes or quickly transferring as many public sector activities as possible to the private sector is unlikely, however, to be the best solution. Experience shows that problems can arise if insufficient attention is paid to competition, regulation, or service standards. So care must be taken to ensure that best practices are adopted.

Maximising the potential of the private sector to serve the community requires close attention to best practices. **Not all of these practices will be applicable in every case:**

- ◆ Legislative constraints
- ◆ Probity
- ◆ Removing barriers to private sector involvement
- ◆ Confidentiality
- ◆ Choosing the best approach
- ◆ Adopting a people-based approach
- ◆ Co-operation in procurement
- ◆ Preparing a well-informed business case
- ◆ Stakeholder consultation
- ◆ Contracting competently
- ◆ Encouraging competition, market development and monopoly avoidance
- ◆ Contracting for value
- ◆ Land
- ◆ Risk assessment/mitigation/transfer
- ◆ Encouraging creative tenders
- ◆ Sound contract management
- ◆ Fair employment
- ◆ Good practices to protect workers' rights
- ◆ Monitoring for results
- ◆ Longer-term evaluation

BEST PRACTICES IN INVOLVING THE PRIVATE SECTOR

Legislative Constraints

Very little legislation was drafted with the concept of Public Private Partnerships (PPPs), or even outsourcing, in mind. Our legislation often does not cater for the private sector to deliver public services or to own and operate related facilities. Provisions often provide that certain duties and functions can be performed only by public bodies, or that certain powers can be exercised only by public officers.

The Public Finance Ordinance (Cap 2) requires that “except where otherwise provided by this Ordinance or any other enactment, any monies raised or received by or for the purposes of the Government shall form part of the general revenue”. This restricts the direct use of the revenue generated from a private sector involvement project to offset the project expenditures or the “netting off” of government payments to the private partner against the revenues.

Departments should obtain advice from the Department of Justice early in their deliberations.

Probity

It is of the utmost importance that departments always give full consideration to probity issues. Any private sector involvement exercise should be conducted in an open, fair and transparent manner and in accordance with the Stores and Procurement Regulations, Financial Circulars, the World Trade Organisation Agreement on Government Procurement (WTO GPA), Independent Commission Against Corruption (ICAC) advice, etc, as applicable. Civil servants involved in procurement and contract management should be alert to situations which may lead to actual, potential or perceived conflicts of interest and departments should ensure that sufficient safeguards are in place to avoid such situations from arising.

It is also important that the private sector should mirror government’s probity standards when involved in government work. Departments should take account of the size, value and status of projects when considering what probity measures should be put in place.

Removing Barriers to Private Sector Involvement

The task of the public sector is often more complex than that of the private sector because it faces multiple and often conflicting policy objectives. This should not, however, prevent an examination of the potential for the community to be better served by using the private sector to deliver services.

A key barrier has been the assumption that certain services are innately public. For example, it was once commonly assumed that all policing was an exclusively government function. Now it is generally agreed that security firms can legitimately protect private property and elsewhere elements of traffic management are commonly outsourced. Nonetheless, there are a number of genuine, common barriers to private sector involvement (see box on next page) that may need to be tackled for any particular procurement and it will be as well to identify and address them at an early stage.

Government’s responsibility is to ensure that services are provided by whoever can do so most efficiently and effectively

Very few services are innately public

TACKLING COMMON BARRIERS TO PRIVATE SECTOR INVOLVEMENT

- ◆ **Town Planning and Land Use:** Depending on the zoning, and the intended use of the site, approval to re-zone the site under the Town Planning Ordinance and/or planning permission from the Town Planning Board may be required
- ◆ **Time:** Some private sector arrangements take longer to prepare than traditional approaches although thereafter the procurement may be more efficient, leading to an overall shortening of the time to service delivery
- ◆ **Staffing:** There is currently no set arrangement for the transfer of civil servants to the private sector and each exercise has to be considered according to its merits on a case-by-case basis
- ◆ **Transparency and Accountability:** Concerns may be expressed that the Government's motivation behind making greater use of the private sector is to limit the accountability to, and scrutiny by, LegCo. This is not the case and should be addressed through stakeholder consultation (see page 12)
- ◆ **Confidence:** Traditional procurement approaches are familiar and understood. This may not be the case for some private sector approaches, for example PPPs, resulting in decisions being made on the basis of "better the devil you know". Using the assistance available from central agencies may improve departments' confidence in following less familiar approaches
- ◆ **Availability of Expertise and Experience:** Departments may be concerned that there is insufficient expertise and experience available in their departments/in government and /or in the Hong Kong private sector to prepare and implement proposals. The EU can advise on addressing this and the other issues above

Care must also be taken to address concerns about possible collusion between government and business. It is perfectly legitimate for aspects of government business to be moved into the private sector, but this should be done in a fair and transparent manner, and allowing competitive bids. Government assets should be transferred at fair market value unless there are policy justifications to do otherwise.

Confidentiality

Some information passed by the Government to contractors, and vice versa, may be sensitive. Departments should put in place practices, appropriate to the level of sensitivity, to handle such information. This may include the "need to know" principle for access to information and arrangements for the physical security of information.

Choosing the Best Approach

The Government has undertaken many forms of private sector involvement but has mostly concentrated on the more direct forms of outsourcing. There are, however, many available approaches that can be considered.

Each approach should be considered on its merits as to whether to apply to a particular project or activity. Once the strategic need for a service or facility has been determined an analysis of options should be undertaken as part of a feasibility study or business case development. Departments are encouraged to give equal weight to consideration of all forms of private sector involvement, choosing according to which will give the best value for money and the most effective means of delivering the service in question. For example, there will be a case for considering PPPs where there is a major investment programme, requiring effective management of risks associated with construction of facilities and delivery of services.

Some activities such as the construction of public buildings have always been outsourced because the Government has not possessed an in-house construction capability

Proposals for private sector involvement should take into account a number of public interest criteria covering: accountability; transparency; equity; public access; consumer rights; security; privacy; and the rights of affected individuals and communities.

GOOD PRACTICES IN PRIVATE SECTOR INVOLVEMENT

Departments should seek to:

- ◆ Conduct market testing to discover if the private sector is willing and able to perform the required tasks;
- ◆ Give potential partners the opportunity to provide feedback on the proposed scheme;
- ◆ Give sufficient publicity and time for potential bidders to prepare proposals;
- ◆ Provide output/outcome performance specifications that clearly identify the service requirements;
- ◆ Arrange briefings and site inspections to ensure potential bidders understand clearly the requirements before submitting their proposals;
- ◆ Look for good alignment of the private partner with the client department's values and beliefs;
- ◆ Put in place an objective and fair bid assessment process;
- ◆ Conduct thorough due diligence to substantiate the preferred bidders' claims (capability, experience, expertise, financial position etc); and
- ◆ Select a private partner, using an objective and fair approach, which the client department will be able to work well with throughout the life of the project.

Adopting a People-based Approach

The Government delivers a wide variety of services to the public, mainly organised on the basis of programme areas. Delivering these services involves many different bureaux and departments, each with their own mission, operational approach and processes. Although there has been considerable effort by departments in recent years to improve the quality of their interactions with citizens, there is still scope for improvement, in particular for services to be delivered in a more coordinated manner across the Government.

For example, providing a range of complementary services, which were previously provided by multiple departments in a single interaction, may minimise a citizen's time and effort in searching and applying for government services. The Government should also be able to optimise resources utilisation and significantly reduce capital and recurrent expenditure over time.

Consolidating the provision of services from individual departments in this fashion also opens the door to involving the private sector in service delivery; either by providing the appropriate infrastructure or, in some cases, supplying the full service.

Co-operation in Procurement

Co-operation between departments in procurement can significantly improve the value of private sector involvement initiatives; departments having common functions should explore joint procurement.

Much improved quality in service delivery may be achieved through putting the public first when designing a service

Many issues go beyond departmental boundaries

Co-operation could also include information sharing, such as performance records of potential service providers or suppliers.

Recognising that the Government is a single entity is critical to the success of cross-cutting projects, such as the operation of shared services centres and the Integrated Call Centre. The successful letting of some private sector contracts also requires the support of departments not directly involved in the service. For example, the Lands Department commonly plays a role in the approval of development projects.

Preparing a Well-informed Business Case

To identify solutions involving the private sector that are truly competitive with the public sector, it is necessary to develop a fully costed business case comparing public and private sector alternatives.

The costs of producing and maintaining facilities or services through the whole of their life are often not fully considered by the public sector. Current practice usually gives separate consideration to capital and running costs, and there is rarely any assessment of alternative solutions for capital projects on the basis of any trade-off between the two.

A well-developed business case should identify a cost-effective combination or bundle of services to outsource. Contracts that cover services from 'beginning to end' can reduce transaction costs and encourage innovative approaches from the private sector.

For example, combined construction and maintenance costs can be lowered if the constructors also have the contract for maintenance, giving them an incentive to put more care into the selection of materials and equipment, and into construction; many projects and programmes are currently divided into 'piecemeal' contracts for separate aspects of the projects.

Contracts that achieve benefits for the community will be more readily achieved if there are programmes large enough to engage the private sector creatively and cost-effectively. For example, building contractors are more likely to invest in innovative designs for schools, roads, hospitals or prisons, and use the advantages of scale in the procurement of materials and in prefabrication, when they can apply these to multiple situations.

PRIVATE FINANCING

Departments should also consider the possibility of using private finance. There is growing evidence that the use of private finance generates high levels of scrutiny of a project, resulting in more certain and improved outcomes.

During a project feasibility/business case study, departments should explore whether the financial community is likely to be interested in financing a project. If it appears that there will be sufficient interest to generate reasonable competition in the provision of project finance, the department should recommend to its bureaux/Financial Services and the Treasury Bureau (FSTB) that this approach should be adopted.

Stakeholder Consultation

The level of consultation for a project involving the private sector delivery of services may need to be greater than that for a conventional procurement. The principles of transparency and accountability mean that it is important for the client department to explain the project to interested and affected parties. For example, using a PPP for the provision of a prison may

Whole life costing can lead to longer term savings

Bundling services can create savings for contractors and citizens

Piecemeal contracts increase transaction costs and limit innovation

Innovative projects and procurement approaches are more likely to have public support if all stakeholders are consulted and kept informed

only refer to the delivery of physical facilities and ancillary services, with the custodial services continuing to be publicly provided. However, the public and staff might fear that public safety was being privatised. Early and thorough communication with all stakeholders can minimise the likelihood of such misunderstandings.

- ◆ Communication will require exceptional handling in those cases where existing services are to be transferred from the public to the private sector.
- ◆ A comprehensive communication strategy should be drawn up from the beginning.
- ◆ Management should consider staffing issues at an early stage, before the first public airing of the subject.
- ◆ Management should inform staff early and regularly of developments.
- ◆ Staff should be offered the opportunity to contribute to the development of any proposals.

CONSULTING STAKEHOLDERS

The ultimate success of any project is due, in part, to ensuring that those individuals or bodies who are directly interested in the project are kept fully informed and properly consulted at all stages of the project. Stakeholder consultation should therefore be:

- ◆ Extensive and involve all interested parties;
- ◆ Open and transparent, providing as much information as possible;
- ◆ Conducted at the earliest stage possible;
- ◆ On-going, maintaining effective dialogue throughout the preparatory and implementation phases;
- ◆ Comprehensive, covering all aspects of the project that are of interest to the stakeholders.

Typical stakeholders include:

- ◆ Relevant policy bureaux / departments;
- ◆ Service users;
- ◆ Staff;
- ◆ Politicians, interest / pressure groups;
- ◆ Local community.

Contracting Competently

Well-prepared and implemented projects will have a higher chance of avoiding and/or dealing with problems that may arise. Experience demonstrates that for all procurements poor drafting of the contract/performance requirements and/or poor contract management and monitoring can lead to problems downstream. The key in entering into contracts of all kinds is to be aware of such possibilities, take expert advice, and manage the contract letting and negotiation processes accordingly. In addition the due diligence, risk allocation, and negotiation processes inherent in letting contracts may allow potential problems to be identified and resolved prior to contract finalisation.

The main elements of a successful relationship between the public and private sectors are to:

- ◆ Select a partner that shares similar attitudes and approaches to key issues;
- ◆ Adopt a partnership attitude supported by the right contractual framework;

Excellence in delivery will only be achieved if contracts are competently drawn up and let

- ◆ Have the right skills mix present at the right time;
- ◆ Have the desire to make partnership work in practice.

Contracts should specify performance-monitoring methods, performance review mechanisms and provisions for enforcement against service levels as well as employment-related requirements (when appropriate). They may also incorporate liability caps, audit requirements, government access rights and provisions for negotiating variations. Contracts may have incentive or efficiency savings sharing schemes so that service providers are incentivised to improve service quality; and departments should link payments to quantitative changes in services.

EXAMPLES OF GOOD PRACTICE IN OUTSOURCING

An outcome-based approach to street cleansing has proved to be beneficial; as has the use of marking schemes in tender evaluation. Others include evaluation of:

- ◆ Bidders' monthly committed wages for non-skilled workers;
- ◆ Compliance with employment-related requirements on an all-or-nothing basis;
- ◆ Bidders' experience in providing similar services and their performance over a 10-year period; and
- ◆ Bidders' proposal on organisation structure, human resources staff training, contingency plan, operation and management plan, transit in and transit out arrangements, etc.

Encouraging Competition, Market Development and Monopoly Avoidance

The Government wants to encourage the further development of high quality in the market for public services. This requires that a competitive selection process be used which insists on quality services, socially responsible terms and conditions, and high health and safety standards. If the Government lays down reasonable expectations, abides by them over time, and provides a level playing field, quality firms will be attracted to the market. This will make it difficult for less socially responsible service providers to survive. Experience shows that it is competition that delivers the benefits, not private provision per se.

Evaluating the competitiveness of the market is an important step in determining the viability of each option. If there is a market with many service providers, the viability of the approach is strengthened. If the market is weak with a limited number of service providers, the department needs to take this into account in its risk assessment. Sometimes there is little or no capability in the local market because the government is the current de facto monopoly supplier. In these circumstances the department must consider whether the necessary skills can be imported or otherwise supplied.

Local players with local knowledge, and the necessary experience and expertise, are used extensively in outsourcing contracts. Some of the smaller companies may be less well placed to lead major projects but would rather participate in bidding consortia, or act as subcontractors.

In determining the nature, scope and length of contracts or other arrangements for private sector involvement in the delivery of public services, departments should balance the need for the best value for money being obtained for the life of the contract (by, for example, bundling together a number of services or geographical areas) with the maintenance of a competitive market over time, and the need to ensure that innovation and new technologies are regularly brought into play.

A fully competitive market for service delivery is necessary if value for money is to be achieved

Contracting for Value

The lowest price is not always the best price. Departments should have value for money in mind in selecting contractors, which is not purely based on price, but also compliance with user requirements, reliability of performance, quality superiority, whole-life costs and after-sale support. In the absence of specified outcomes and related management controls, low prices may lead to poor quality as contractors seek to protect their margins. Contracting and partnership arrangements built on a mutual recognition of value for money, rather than cost-driven arrangements, are more likely to produce long-term benefits for the community.

For non-government organisations (NGOs) and charities, alternative contract arrangements may sometimes be appropriate. However, some grants given in the past have relied on detailed specifications of inputs and outputs. As a result, staffing and terms of employment in many NGOs have been virtually the same as those in the civil service. This has raised their costs and given them little room to develop their distinctive cultures and character – which is what attracts some people to their services. It has also limited their scope for innovation.

Best practice suggests that contracts with NGOs and charities should be similar to contracts with the private sector, with arms-length relationships that allow for variation and innovation in the services provided.

Opportunities also involve risks. When entering a contract with the private sector, the public sector may recognise and quantify some kind of risks for the first time. For example, risks to the level of demand for a service are rarely considered by the public sector, except under private sector contracts where the viability of the contract may rest on a minimum level of demand.

Land

Land resources in Hong Kong are scarce and of high value. When a project involves the transfer of land to the private sector, departments should ensure that the permitted development parameters are clearly defined and any land value that can be exploited by the private sector is reflected in the contractual or other arrangements. Land premium waiver or grant of development rights should not be used as the major incentive for the contractor to provide the Required Facilities. Otherwise, the well-established tendering procedures policy will be in jeopardy and projects may be criticised for bypassing proper procedures. Land revenue may also be hypothecated. Departments should consult the Lands Department at an early stage.

Risk Assessment/Mitigation/Transfer

Risks relate to the occurrence of events whose consequences will have an effect on the outcome, either positive or negative, of a project. Exposure to risks arises in all projects, whatever the approach. Private sector involvement may provide opportunities for the better management of such risks by allocating and sharing them appropriately between the public and the private sectors. It is important that the allocation of risks is defined in a clear, unambiguous contract that sets out the risks, who takes them, and what are the consequences of and actions to be taken when the risk event actually occurs.

It is important that departments guard against the possibility of the government sector being left with most of the risks in exchange for only a share of the benefits. The private sector sometimes assumes that the government will underwrite the risks. Recognising, allocating and managing the risks associated with private sector projects will remain a key responsibility of departments. Departments should be prepared to negotiate for a more balanced sharing of

Seek value for money, not just the lowest prices

Offer flexible grants to NGOs that give them scope to be alternative providers

Recognise risks

Make sure government does not have most of the risks but only some of the benefits

risk. The party best able to manage each risk should carry that risk. In most projects this will mean that the client department retains some risks, the private partner carries other risks, and some risks are shared. Generally the client department would be expected to bear any risk arising from variations required by the government, or discriminatory or specific changes in the law. The private partner would be expected to carry or share most other risks including general business risks. The willingness of a bidder to accept risks and the proposals for mitigating them can be an element in assessing and ranking bids.

Political responsibility cannot be transferred

The public and politicians will always hold government responsible for public services irrespective of the mode of delivery. Government's political risk of failure, and other risks borne by the government should come at a cost to the private sector. Some risks may not be transferable because they will make the project too commercially unattractive and financiers will be unwilling to fund the project. For example, there must be sufficient likelihood that the demand for the service (from the public or the client department) will generate sufficient income to meet the cost of provision of the service and provide a return on capital. The transfer of 'demand' risk to the private partner will be unachievable where there is high uncertainty about the level of demand, constraints on the private partner in generating demand, or the client department is able to limit demand.

Encouraging Creative Tenders

Be clear about the outcomes intended

The department must be the judge of whether a tenderer meets the needs and standards required. To gain from private sector innovation, however, it must concentrate on what it is that a service is trying to achieve. Specifying outcomes, rather than inputs, means that bidders can propose different ways of meeting the goals.

Allow non-conforming contracts

A clear focus on the desired outcomes will also allow fair consideration of both conforming and what might be considered non-conforming bids under traditional procurement. Creative tenders, offering new solutions, may then allow new contractors to offer competition to existing contractors. This ultimately benefits the purchaser.

Balance contractual details with the freedom to innovate

In calling for tenders, departments should balance their desire for the detail, which is needed to ensure performance, with allowing sufficient scope for differentiation by intending suppliers – giving them room to innovate in the substance of their bids, not just with prices.

Less detailed specification of tenders can often result in reduced tender prices.

Sound Contract Management

Contract management is a separate skill that needs to be applied with sensitivity to achieve a balance between control and delegation

If implemented properly, effective contract management and supervision will identify, monitor and manage all risks over the life of the project contract to assist in achieving project objectives. This will include:

- ◆ Identifying actual and potential risks and quantifying their likely impacts so that those risks can be managed over the life of the contract; and
- ◆ Developing management strategies to assume, control, mitigate or eliminate such risks

While significant attention is given to the tender, procurement, evaluation and contract negotiation phases, rather less consideration is often given to contract management issues. While performance can be driven through appropriately structured performance incentives or abatement regimes, sound contract management arrangements are required to ensure performance standards meet, and preferably exceed, expectations throughout the contract life.

To manage large, complex, high value projects, it is unreasonable to expect non-works departments' staff to develop quickly the necessary contract/project management skills. It is

often more sensible, practical and cost-effective to employ someone who already has those skills. This will often involve engaging non-civil servants. Effective contract management supplements the allocation of project risk in project documentation. Failure to develop and implement an effective contract management strategy for the project is, in itself, a project risk that must be managed.

Departments should monitor service providers' performance and compliance with employment-related requirements through performance review meetings, performance reports submitted by contractors and on-site inspections/supervision. Major contract management issues include service delivery and compliance, enforcing performance against service levels, and performance evaluation and reporting. Contract management should be based on relationship management within a partnership framework rather than overly rigorous enforcement of each contract condition.

It is essential that the contract manager has a clear understanding of the requirements of the contract including government's rights and obligations therein and the rationale for those contractual requirements. Departments should ensure that all pre- and post- contract dealings are fully documented as it is likely that once the contract is signed, the project team will be disbanded to a greater or lesser extent; otherwise the contracting authority may lose a full understanding of the contractual requirements and their underlying justifications, during the remainder of the contract term.

Sound contract management does not imply interference in decisions that should be taken by contractors.

More detailed advice can be found in the EU's 'User Guide to Contract Management' available at www.eu.gov.hk.

Fair Employment

The Government has introduced a number of service-wide measures over the past couple of years to protect non-skilled workers from exploitation. Most of these measures apply mainly to outsourcing contracts.

From March 2004, the Government implemented mandatory requirements for tender assessment and a Demerit Point System (DPS) to tenders for government service contracts that rely heavily on the deployment of non-skilled workers (referred to as relevant contracts). The mandatory requirements were tightened from May 2006. For tender assessment, a tender offer should not be considered for a period of five years from the date of conviction if the tenderer has obtained any convictions for specified offences under the Employment Ordinance, Employees' Compensation Ordinance, the Immigration Ordinance, the Mandatory Provident Fund Schemes Ordinance or the Criminal Procedures Ordinance on or after 1 May 2006. Under the DPS, procuring departments are required to issue a default notice to their contractors for each breach of contractual obligations in respect of wages, daily maximum working hours, signing of Standard Employment Contracts (SECs), and wage payment by autopay to its non-skilled employees (except temporary leave relief workers). Each default notice will attract one demerit point. A tender offer should not be considered for a period of five years from the date the third demerit point is obtained if the tenderer has, over a rolling period of 36 months immediately preceding the month of the tender closing date, accumulated three demerit points obtained on or after 1 May 2006 from one or more departments. The DPS had a deterrent effect on contractors from adopting malpractices that undermine the rights and benefits of non-skilled workers.

Since May 2004, the Government has introduced a mandatory wage level requirement to

The Government is determined that workers on public service contracts will receive fair treatment from their employers

tenders for relevant contracts. A tender offer shall not be considered if the monthly wages offered by the tenderer to its non-skilled workers are less than the average monthly wages for the relevant industry/occupation as published in the latest Census and Statistics Department's Quarterly Report of Wage and Payroll Statistics at the time when tenders are invited.

In April 2005, the Government required contractors of relevant contracts to sign an SEC with their non-skilled workers. The key features of the SEC are that the monthly wage payable to a non-skilled worker should be no less than the amount committed by the contractor in the relevant tender offer; the working hours should be set out clearly; any allowance should be paid on top of the committed monthly wage; no fee or deposit should be collected from their non-skilled workers; all wages should be paid directly by autopay into the individual employee bank account; the workplace should be specified; and copies of signed SEC should be kept by the contractor, the worker and the relevant procuring department.

Good Practices to Protect Workers' Rights

The following practices, which are good if carried out with a sense of proportion, and with due regard to risk, have assisted in protecting the rights of workers:

- ◆ Posting notices conspicuously at workplaces containing employment-related information such as committed monthly wages and telephone enquiry hotline numbers;
- ◆ Random checks of employment-related records;
- ◆ Surprise interviews of workers;
- ◆ Taking prompt action if irregularities are detected/reported;
- ◆ Reporting appropriate cases to law enforcement agencies;
- ◆ Monitoring closely the change of contractors upon contract expiring/termination and rendering appropriate assistance.

The extent of such activity should avoid disproportionate use of departmental resources, and should focus more on contractors with bad records. When seeking to verify payments or obtain other data, departments need to be sensitive to privacy issues.

Any department considering legislation, public policy or programmes is required to promote the elimination of discrimination against women. In the PPP context this might, for example, involve ensuring that the contractor's female employees are given equal employment opportunities and pay. The Women's Division of the Health, Welfare and Food Bureau can advise details of gender mainstreaming requirements.

Monitoring for Results

Monitoring is important to ensure the public interest is safeguarded, and that the terms and standards of a contract are maintained. Departments should establish a proper mechanism to effectively and efficiently monitor contractor's work and results so that remedial actions, if any, could be taken at the earliest opportunity. Typically, the contractor should make a report on its own performance; this should be subject to independent checking for its coverage and accuracy.

Monitoring which is too detailed may choke a service by complexity, in the same way as over-prescription in a tender document or contract. The intentions of a flexible contract may be defeated also by too narrow an interpretation, the unwritten details of which become the effective contract. This may create unintended costs for the delivery of the service.

Equally, being too zealous about the frequency of monitoring has costs. Too much surveillance will intrude on a supplier's operations and reduce its flexibility and profits. While monitoring of standards remains important, most important is a focus on whether results have been

The need for monitoring and the need for efficiency must be balanced

Monitoring should focus on whether outcomes have been achieved, not inputs provided

achieved. Performance should not be judged on sterile conformity with contractual inputs.

The service provisions will be based largely on output/outcome-based performance specifications contained in a service level agreement. Whilst client departments should avoid setting up costly and elaborate supervision of contractors, they should ensure that each project has a suitably skilled and experienced Contract Manager, with the necessary support. In some cases, the private partner may require licences to operate the service. Consideration of licence applications, and their renewal/revocation may provide further opportunities to monitor operational performance.

ACCESS TO MONITORING INFORMATION

To facilitate the Contract Manager's work, the contract should require the production and monitoring of suitable performance indicators by the private partner, which should be provided on a regular basis to the client department and be the subject of independent review and/or audit. To this end, the contract provisions should permit the department to:

- ◆ Have physical access to the facility at all reasonable times
- ◆ Have access to the accounts and other records of the project
- ◆ Require user-satisfaction surveys to be conducted
- ◆ Require the publication of regular reports on contractual performance
- ◆ Appoint auditors

Longer-term Evaluation

Surveys of departments of their reasons for utilising the private sector have shown that cost reduction is not one of the highest priorities. For some departments, cost savings cannot be readily measured since the services outsourced have never been performed in-house. Other departments cannot readily provide the information.

It is good practice to estimate the cost of projects on an in-house basis wherever possible (a Public Sector Comparator) to provide a budget for the project and a benchmark against which to measure bids. Once underway, departments should monitor the cost of projects in order to assess the extent to which expected financial results are realised and to take remedial action where they are not.

Evaluation differs from monitoring by being a periodic event rather than an on-going activity. But that is often the reason why it is overlooked. Evaluation should always be undertaken when a contract is being relet, or when a policy is being reconsidered. It should cover all aspects of the service, not just those being provided by the private sector. It should reach more deeply than monitoring - asking not only 'are we doing things right?' but also 'are we doing the right things?' It should test whether the desired results have been achieved and whether they remain the right goals to strive for.

Because it goes further than monitoring, evaluation should normally consider longer-term value for money, as well as efficiency in dealing with current issues and costs. In addition, evaluation should build in the government's obligation to consider the likely desires, values and needs of future generations. The costs of evaluation are therefore normally borne by the government rather than being passed on to private sector suppliers.

Evaluation is often the missing step – it looks at total results and asks if the goals remain relevant

Evaluation considers the longer term, and the Government bears that cost

TYPES OF PRIVATE SECTOR PROCESSES AND INVOLVEMENT

Purchaser/Provider Agreements include:

- ◆ Contracting in
- ◆ Outsourcing/Contracting out
- ◆ Grants and Subventions

Public Private Partnerships include:

- ◆ Private finance initiatives
[These are often known by acronyms such as: BOOT (Build Own Operate Transfer) also known as DBFO (Design Build Finance Operate); and BOT (Build Operate Transfer)]
- ◆ Franchises
- ◆ Joint ventures
- ◆ Partnership companies
- ◆ Partnership investments

Privatisation/Private Sector Provision include:

- ◆ Asset sales
- ◆ Sales of shares in government owned enterprises
- ◆ Management buy outs
- ◆ Market provision of services
- ◆ Withdrawal of public services

The range of strategies or initiatives that involve the private sector set out below are not exclusive options. They can overlap and interchange.

Purchaser/Provider Agreements cover:		
Contracting in		
<i>Definition:</i> using private sector staff or expertise under in-house management, in order to supplement the resources of the department.	<i>Opportunity:</i> to add to the department's ability to deliver outputs immediately, when pressure is intense. Contracting in can manage the risk that there will be insufficient resources to meet unpredictable or growing service needs.	<i>Challenge:</i> to ensure that in-house staff and expertise are not neglected, and that future supply is safeguarded through well managed contracts.
Outsourcing/Contracting out		
<i>Definition:</i> contracting with an external party to provide specified services over an agreed timeframe.	<i>Opportunity:</i> to improve service quality by accessing private sector skills, innovation and technology; to allow government to concentrate on priorities; to more rapidly deliver new services to the community and capitalise on new opportunities.	<i>Challenge:</i> to contract for outcomes and value for money, not just inputs and lowest price; to maintain sufficient control over the contract through monitoring results without stifling the contractor's initiative.
Grants and Subventions		
<i>Definition:</i> payment of a one-off sum or renewable lump sum to a private sector organisation or NGO to provide a service.	<i>Opportunity:</i> to augment the department's power to deliver a service through using agents who have expertise in dealing with similar clients.	<i>Challenge:</i> to ensure that the conditions for the grants allow the outside organisations to maintain its brand character, and to operate processes such as using voluntary staff. At the same time, conditions should be sufficiently specific to enable monitoring of outputs or outcomes.

Public Private Partnerships cover:		
Private finance initiatives		
<i>Definition:</i> launching new initiatives using private sector skills and finance to utilise the assets of the public sector, both physical and intellectual.	<i>Opportunity:</i> to exploit the potential of assets, which cannot easily be sold, and to share in the returns.	<i>Challenge:</i> to identify where such potential exists, and to ensure that the taxpayer receives a fair share of the returns.
Franchises		
<i>Definition:</i> a concession awarded by the government to a private sector organisation to provide a public service for an agreed period. The private sector organisation pays a fee during this period for the revenue (or a share of the revenue) that the service generates.	<i>Opportunity:</i> to maintain ownership, but use the private sector to deliver services efficiently.	<i>Challenge:</i> to define the standards of service provision that ensure good coverage and quality of service but also the opportunity for the private sector to profit by innovative efficiencies. Further, to apportion the risks of poor performance so that government is not left with most risks but relatively fewer benefits.
Joint ventures		
<i>Definition:</i> partnerships in which public and private sector partners pool their assets, finance and expertise under joint management, to deliver long term growth in value for both partners.	<i>Opportunity:</i> to exploit the latent potential of government assets, and share the risk of delivering policy objectives and commercial objectives. Joint ventures can include contractual agreements such as licenses, profit and revenue sharing agreements, or formal corporate ventures.	<i>Challenge:</i> to judge when to use joint ventures rather than more conventional partnerships, and to create the right balance of risks and rewards for the public and private sectors. Structures need to work commercially, and be sufficiently robust to withstand public scrutiny.
Partnership companies		
<i>Definition:</i> introducing private sector ownership into government-owned businesses, while preserving the public interest and public policy objectives, through legislation, regulation, partnership agreements, or retention of a special government share.	<i>Opportunity:</i> to bring in the benefits of private sector ownership, including private sector investment and management skills.	<i>Challenge:</i> to safeguard any continuing public sector interest in such assets, and to ensure the taxpayer receives value for money.
Partnership investments		
<i>Definition:</i> partnerships in which the public sector contributes to the funding of investment projects by private sector parties, to ensure that the public sector shares in the return generated by these investments.	<i>Opportunity:</i> to overcome market failure by providing finance for projects with commercial potential. Usually, the size, risk, or timescale of the investment, or the political context, mean that the capital markets are unable to fund fully the costs. Partnership investments allow the taxpayer to share in the future returns from the project.	<i>Challenge:</i> to ensure that such investments offer value for money. In particular, that the terms of the investment provide the public sector with returns commensurate with the risks it is taking on.

Privatisation covers:		
Asset sales or transfers		
<i>Definition:</i> the sale or transfer of surplus public sector assets.	<i>Opportunity:</i> to release the potential of public sector assets by exploiting private sector finance, management, and other skills and capabilities.	<i>Challenge:</i> to safeguard any continuing public sector interest in such assets, and to ensure the taxpayer receives value for money.
Sales of shares in state enterprises		
<i>Definition:</i> the sale of shares in state-owned businesses, by flotation or trade sale. This can be either the sale of a minority stake or a majority stake.	<i>Opportunity:</i> to improve management performance through private sector investment and capital market disciplines and thereby release the potential of state-owned businesses.	<i>Challenge:</i> to ensure benefits are shared fairly with employees, customers and taxpayers by establishing competition, regulation or other mechanisms to protect the public interest; linking the timing of the sale to meeting targets on growth of shareholder value; and providing incentives to improve performance in the run up to the sale and beyond.
Management buy outs		
<i>Definition:</i> where the employees of a department raise the finances to buy the assets and establish an independent business to provide the service. This is commonly led by management but can involve all employees.	<i>Opportunity:</i> to build on existing expertise, operational processes and customer loyalties but shift service provision to the private sector. The private sector grows by the addition of a new player, without loss of employment for staff.	<i>Challenge:</i> for the new business to be competitive, which may require changes to its current modes of operation and conditions of employment. The risk that the public may see the new business as ‘underwritten’ by government needs to be managed.
Private Sector Provision covers:		
Market provision of services		
<i>Definition:</i> the private sector meeting a defined community need without direct recourse to public funds or other public resources.	<i>Opportunity:</i> to encourage or enable the private sector to directly meet a community need, often by removing regulatory constraints, social funding arrangements or changing the competitive environment.	<i>Challenge:</i> to ensure that both users and the competitive environment are protected through appropriate regulation without stifling the efficient and innovative provision of the service.
Withdrawal of public services		
<i>Definition:</i> winding up a public service where private sector providers are adequately meeting demand.	<i>Opportunity:</i> to reduce both public expenditure and burdens on public sector managers.	<i>Challenge:</i> to redeploy current staff and assets.

TAKING ADVICE AND GUIDANCE

The EU is able to offer to departments general advice on institutional change as well as PPPs and other private sector involvement opportunities, and can advise on external sources of advice. It can provide consultancy support by conducting business case/feasibility studies, as well as:

- ◆ Assisting in preparation of procurement documents
- ◆ Advising on outsourcing and PPP issues

The EU also:

- ◆ Publishes guides and reference materials, and organises and delivers training and seminars on outsourcing and PPPs
- ◆ Provides help desk services (Tel: 2165 7255)

The CSB will advise on issues affecting civil service staff.

The DoJ will provide assistance on preparation and drafting of procurement documents.

The FSTB (Treasury Branch) should be consulted on the appropriate funding and procedures involved in seeking FC/PWSC endorsement. It will:

- ◆ Advise on financial/funding issues
- ◆ Vet funding applications for both capital funding and recurrent consequences and earmark funding for projects in Resource Allocation Exercises
- ◆ Provide support to the process of seeking funding approvals from Finance Committee
- ◆ Advise on tendering issues and vet bid evaluation methodology

The GLD provides advice to departments on general procurement matters under the Stores and Procurement Regulations.

The HWFB (Women's Division) provides advice on gender mainstreaming requirements.

The ICAC will provide assistance on managing probity and corruption risks.

The LD can advise on measures to mitigate risks in the field of employment (particularly avoiding the exploitation of non-skilled workers by contractors).

The OGCIO can advise on projects involving the provision of information technology infrastructure and services.

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