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Public-Private Partnerships

A Case Study of the Pelonomi and Universitas Hospital Co-Location Project

Abstract

Whilst there has been an increase in the number of public-private partnerships over the past five years, the question as to whether these partnerships have been successful has been posed from several quarters and needs to be addressed. This chapter presents a case study of a public-private partnership in the Free State and provides some insight into this question.

In 2000, the Free State Department of Health embarked on a process to make available underutilised hospitals in the Free State for the establishment of private hospitals in partnership with public institutions. This process identified Pelonomi and Universitas Hospitals in Bloemfontein as suitable institutions for the establishment of an independent private hospital using surplus infrastructure within both institutions, through a co-location model of public-private partnerships.

This chapter evaluates the success of the partnership four years into the implementation of the project in the Free State using qualitative and quantitative measures, and presents a number of recommendations for public-private partnerships in general.

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Introduction

There is increased realisation by the South African government for the need to structure sound deals with the private sector to improve public service delivery.

The Minister of Finance noted that, *"The state must complement its budgetary capacity with the wealth of innovative and special skill that is available in the private sector... The availability of state resources for these purposes must be used to leverage much-needed private sector investment in public infrastructure and services"*.[1]

The Draft Health Charter defines public-private initiatives (PPIs) as:

"a Public Private Interaction in terms of which one or more persons or entities involved in health care within the public sector interact with one or more persons or entities involved in health care within the private sector or the NGO sector with the object of achieving a mutual benefit or goal and includes, but is not limited to a Public Private Partnership. PPIs include public financing of health services provided by the private and / or NGO sector; private financing of publicly provided health services; innovative health care delivery models and business models for health practices; delivery models aimed at retention and effective distribution and utilisation of skills; use of public assets for the provision of health services by the private sector; use of private assets for the provision of health services by the public sector."[2]

The objectives of PPIs are summarised as follows:

- public sector leveraging private finance to strengthen the public sector;
- sharing of scarce resources between the sectors to maximise benefits for the broader population;
- improvement in the quality of services rendered; and
- promoting equitable allocation of resources.

Public-private partnerships

A public-private partnership (PPP) is a form of PPI. The use of the term PPPs in the South African context has a specific meaning and usually refers to partnerships that have been registered with, and approved by National Treasury. A PPP is defined as *"a contractual arrangement between a public sector institution and a private party in which the private party performs an institutional function or uses state assets and assumes substantial financial, technical and operational risk in the design, financing, building and or operation of the project, in return for a benefit"*.[3]

This definition is important because it provides a basis to distinguish PPPs from other types of interaction between the public and private sectors. Where the association results in a project that does not transfer substantial financial, technical and operational risks, then it cannot be seen as a PPP. These kinds of partnerships do not require the participation and facilitation of National Treasury and should be regarded as public-private interactions, and not PPPs. An example of this would be a public sector institution that has an operational budget of R550 million and commissions the services of a private sector company to provide it with security services at a cost of R1.5 million per annum. As the risks associated with this contract are not significantly substantial, this project would be viewed as an outsourcing type of a PPI and not a PPP.

According to National Treasury, each PPP should be conceptualised, planned and executed as a project, in accordance with the steps outlined in the PPP manual, to ensure full compliance.[4] The manual proposes that before any PPP agreement is signed, the preparatory steps outlined in Box 1 should be substantively followed.

This is not a simple process. Depending on the experience, insight, goodwill, competence and skill of the negotiating partners, this process can take a period of between twenty-four to thirty-six months.

Successful partnerships in health care delivery have been reported in both developed and developing countries and these provide critical lessons and serve as useful case studies for future PPPs.[3,5]

Co-location PPPs

This case study describes a co-location PPP, a type of PPP, which occurs when the public and private sectors operate a similar service and collaborate rather than compete, resulting in the receipt of revenue by the public sector and the generation of profit by the private sector in a win-win enterprise. It occurs where the public sector has redundant assets and the private sector has sound commercial reasons for the utilisation of these excess State assets.

A co-location PPP is characterised by long-term contracts with substantial capital and operational costs. It requires National Treasury to act as facilitator, mainly to protect State assets by ensuring that there is compliance with the following principles:

- Affordability to the public entity
- Risk transfer to the private entity
- Value for money for the public entity

Box 1: PPP project preparatory phases

A. Inception:

- Registration of project with treasury
- Appointment of Project Officers
- Appointment of Transaction Advisor

B. Feasibility Study:

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Economic evaluation
- Procurement plan

TREASURY APPROVAL: 1

C. Procurement:

- Design a fair, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including a Draft PPP Agreement

TREASURY APPROVAL: 2A

- Pre-qualify the parties
- Issue requests for proposal with the Draft PPP Agreement
- Receive bids
- Compare bids with Feasibility Study and with each other
- Select the preferred bidder
- Prepare a value-for-money report

TREASURY APPROVAL: 2B

- Negotiate with preferred bidder
- Finalise PPP Agreement Management Plan

TREASURY APPROVAL: 3

Signed PPP Agreement

Source: National Treasury, 2004.[4]

Although there has been an increase in the number of co-location PPPs over the past five years, the question posed from several quarters, which needs to be addressed, is whether these partnerships have been successful. The complexity of PPP relationships needs to be fully understood and appreciated when attempting to provide answers to this question.

The Pelonomi and Universitas Hospital co-location PPP project

Voluntary partnerships are brought into existence by a need that exists between two or more parties which can only be addressed through the formation of a partnership. The Free State PPP was driven by the mutual needs of both the public and the private sectors to address specific challenges.

Description of the project

The Free State Department of Health (FSDoH) faced major challenges in 1998, compelling it to look beyond its usual approach to address them. The three Bloemfontein hospitals namely, Universitas, Pelonomi and National were originally built, staffed, equipped and managed separately to serve the White and Black communities pre-1994.

As part of the transformation process aimed at ensuring equity and health care service delivery that is accessible, effective and efficient, it became necessary for the FSDoH to address the challenges of duplication, inefficiency and inequity inherited from the apartheid past. The overall objective of the transformation process was to eradicate racial fragmentation through the realignment of the services which resulted in National Hospital becoming a district level hospital for Motheo health district; Pelonomi Hospital becoming a regional level hospital for the southern Free State province and Universitas Hospital becoming a tertiary level hospital for the province. This process resulted in the reduction in the number of beds in the public sector from 2100 to 1600. Public facilities were left with excess infrastructure that was under-utilised, as well as with excess capacity in some hospital services such as theatres, radiology and intensive care units (ICUs). This excess capacity presented the public sector with an opportunity and a basis for contracting with the private sector.

During 1997, the national health facilities audit revealed that the Free State required R825 million to address its facilities backlog. Pelonomi Hospital's facility backlog alone was estimated at R100 million. This was clearly unaffordable for the

FSDoH, given the limited capital budgets available at the time. The FSDoH was also faced with an increasing demand for health care services and a budget that was shrinking in real terms.

Private hospital providers were faced with the urgent need to increase the number of private hospital beds in the Bloemfontein region resulting in the submission of requests to government for private licensing. The major constraint for the private sector however, was that it had already exceeded the norms and standards for the number of beds, in this region and a license for new beds was therefore not issued.

In November 2003, the FSDoH entered into a 20 year concession agreement with Community Hospital Management (Pty) Ltd (CHM). The project was referred to as the Pelonomi-Universitas Hospital Co-location PPP. The private CHM partner was allocated an empty ward at Universitas Hospital to operate a private hospital (known as Universitas Private Hospital). In terms of the concession agreement, Pelonomi CHM injected capital (R20 million) towards the upgrading of a public medical ward, theatres and ICU blocks. In addition to the R20 million capital injection, the public sector would receive a percentage of the turnover generated by the private hospital and the State would retain ownership of all the buildings after the concession period.

The objectives of the partnership were:

- To combine the strength of both the public and private sector to better utilise the government resources and to share scarce technology and specialists.
- For the private sector to invest funds in the improvement and maintenance of existing public facilities for exclusive use by the private or public as well as for joint use by both parties.
- For the private sector to generate income from hospital related activities, to the benefit of both parties.
- To generate employment and transfer of skills to the population of the Free State.
- To improve the image and aesthetic appearance of the public facilities.
- To improve service provision in the public hospital through close association with the private sector, as well as through provision of certain services to both parties by the public hospital.
- For the private partner to gain commercial return of their investment from the venture.

Evaluation of the project

The co-location PPP between the CHM the FSDoH is the first of its kind in the South African health sector. The concession period of this contract is 20 years and includes an evaluation component to be conducted in the fourth year of implementation.

In order to obtain a comprehensive picture of the substantive progress made, it is important to examine both the qualitative and quantitative aspects of the project.

The **quantitative** assessment and review of the project will focus on the deliverable targets outlined in the contract. These targets include:

- capital investment by the private sector partner for the use of both public and private sector;
- capital investment by the public sector partners;
- Black Economic Empowerment (BEE) benefits during the construction phase;
- BEE equity benefits for Free State based investors / partners; and
- income accrual to the public partner based on a fixed monthly fee and a percentage of annual turnover over the period (fixed R40 000 monthly rental fees for the first 5 years and thereafter R60 000 monthly and 1.32% of annual turnover before expenses to be paid quarterly).

The total capital investment by the private sector partner was R70.9 million. Of this total R41.6 million was allocated for renovations of the private ward, purchase of equipment and building of a medical centre at Universitas Private Hospital. The balance of R29.3 million was utilised for renovations and upgrading of public wards at Pelonomi as well as Pelonomi Private Hospital. In terms of the contract, the public sector partner was also required to inject capital investment of approximately R11.03 million to upgrade facilities (see Table 1).

Table 1: Capital investment by the private and public sector (Rand million)

Capital Investment by private partner	
Universitas Hospital	
Renovations to 8th and 9th floor	15.2
New private medical centre	24.7
New medical equipment	1.7
Subtotal	41.6
Pelonomi Hospital	
Renovation of public hospital	23.6
Construction of private hospital	5.7
Subtotal	29.3
Total	70.9
Capital Investment by public partner	
Universitas Hospital	
Upgrading of lifts	2.5
Patient transport and parking	0.25
Payments on practical completion	5.78
Subtotal	8.53
Pelonomi Hospital	
Payments on practical completion	2.5
Subtotal	2.5
Total	11.03

Source: Maharaswa, 2006.[a]

The significance and impact of this investment in infrastructure by both parties was that although the use of infrastructure will be shared by both parties, the public sector ultimately owns the infrastructure at the end of the contract. This investment gain for the FSDoH and more broadly the Free State economy, would not have been possible given the limited annual budgetary allocations in the public sector.

This partnership also resulted in the direct creation of jobs as a result of the construction work related to the contract. According to Table 2, thirty-five local people were appointed by the construction company during the forty-two week's construction period at both Pelonomi and Universitas Hospitals at a cost of R474 750. At the end of the construction period, thirty-eight people were permanently appointed by the construction company at a cost of R62 700 per month.

During the construction phase, work was outsourced to local sub-contractors. This was one of the stipulations of this partnership contract, and is in line with government policy on economic development and support of small, micro and medium enterprises (SMME). These local sub-contractors, who were drawn largely from the previously disadvantaged communities, were commissioned projects to the value of approximately R10.2 million. Twenty-six local sub-contractors benefited from this phase of the project.

Table 2: SMME and BEE revenue benefits during construction (Rands)

No. of employees appointed during construction	35	474 075
No. of employees appointed after construction	38	62 700
No. of employees that were previously unemployed	20	
No. of Bloemfontein based sub-contractor companies	26	10 215 475

Source: Maharaswa, 2006

According to the contract the private partners are expected to pay a fixed monthly rental fee of R40 000 per month for the utilisation of the co-located facilities for the first five years and R60 000 per month thereafter. In addition to this, 1.32% of the annual turnover before profit is to be paid back to the public sector. The accumulated revenue over a 4-year period is illustrated in Table 3. The total accumulated revenue for the financial year-end March 2007 was R9.58 million (R8.14 million and R1.44 million for fixed turnover and rental respectively).

a Personal communication, MB Maharaswa, PPP Project Manager, Free State DOH, 2006

Table 3: Fixed revenues from turnover and rentals (Rands), 2004-2007

	2004	2005	2006	2007
1.32% of turnover	2 716 000	2 716 000	2 716 000	8 148 000
Rental	480 000	480 000	480 000	1 440 000
Total revenue	3 196 000	3 196 000	3 196 000	9 588 000

Source: Schoonwinkel, 2007.[b]

The contract also stipulated that a stake in the equity shares of CHM should be offered to previously disadvantaged communities. This was achieved after successful negotiations between CHM and Afrinnai, a local Black empowerment grouping in the Free State. The exact monetary value of this deal is subject to strict confidentiality.

The **qualitative** benefit of this project covers a wide spectrum and refers to all potential benefits that accrue to the FSDoH and the larger Free State community. These benefits which cannot be quantified at this stage, but will be assessed and determined as the project progresses, include:

- contribution to economic growth in the province through this investment;
- poverty alleviation through job creation;
- improvement of the quality of health care services;
- attraction, recruitment and retention of scarce skills; and
- improved efficiency in public and private health care.

The establishment of two private hospitals located at Pelonomi and Universitas respectively, resulted in the introduction of new private health care services and facilities in the Bloemfontein area. The placement of specialised academic health care services in a facility that allows free access and interaction between private and public sector service providers is unique and has immense benefits. This arrangement allows for academic specialists to train and support both public and private sector service providers in order to improve the overall quality of health care services for both public and private patients. It also brings the highly specialised academic service providers in contact with state-of-the art equipment and technologies that the private sector can afford, in order to provide patients with high quality health care services.

The partnership project enables the public sector to provide its specialist workforce at the tertiary institutions in Bloemfontein with a platform and specific incentives to do remunerated work outside the public service. This means that specialists no longer have to conduct their remunerated work outside the public service at practices away from the public institutions, but can now do this on site. This incentive enables the FSDoH to attract, recruit and retain specialised skills and services that would have otherwise been lost to the public sector.

The establishment of the private facilities also creates the risk that scarce human resources, such as nurses, could be lured away from the public sector to these facilities. To minimise this impact, the FSDoH and CHM agreed to a code of conduct providing for oversight by a joint liaison committee and an undertaking that each of the parties would not poach scarce personnel.

The co-location project offers the public a choice between private and public health care at the same locale, cost permitting. The economic spin-offs via the accelerator effect and the direct jobs created during and after the construction phase of the project, will reduce unemployment and improve poverty alleviation.

b Personal communication, AJ Schoonwinkel, Chief Financial Officer, Free State DoH, 2007.

Conclusion

The introduction of PPPs in South Africa has been one of the more significant health care reforms in recent years in accelerating the efficient delivery of health care services at costs that are affordable. These projects have resulted in major infrastructural investment, economic and social benefits, which would otherwise not have been possible with the limited public resources.

Arguments are often advanced that PPPs are invariably skewed in favour of the private sector and the public sector rarely succeeds in leveraging benefits on behalf of the public. These arguments bestow upon the private sector undeserved accolades, whilst perpetuating the myth of public sector incompetence and corruption.

The truth is that PPPs are voluntary in nature and are a product of often protracted negotiations, where all the parties can apply their minds, obtain the best advice and take well considered decisions. The involvement of the National Treasury in the approval of the major PPPs and the active support that they provide throughout the process from negotiation to project implementation, ensures that the possibility that State assets will be plundered by the private sector is kept to a minimum. These measures assist to ensure that PPPs will not materialise unless the projects can be proved to be affordable, there is risk transfer to the private sector partners and the public sector gets value for money from the partnership.

In this co-location project, the public sector has been able to maximise the utilisation of its assets for the highest returns with the private sector gaining 'additional' beds and income. From the evaluation, it is evident that this partnership has benefited both parties and that these benefits are expected to be delivered throughout the term of the contract. It is also clear that these benefits have come at a cost to both parties; these costs are however a result of the calculated risks that each partner took in the signing of the contract.

Recommendations

The following recommendations are made for PPPs in the health sector:

- Clear objectives, targets and success indicators for the project should be negotiated, set and communicated to all stakeholders at the signing of the contract. This will ensure that periodic evaluations can be done with ease to measure the success of the project.
- Regular monitoring and periodic evaluation of the project should be undertaken to ensure that the objectives and benefits of the partnership accrue as per the contract agreement.
- An effective and supportive institutional framework is necessary to support the implementation phase of the PPP.
- Effective capacity and skills need to be developed in the public sector to successfully negotiate and manage PPP contracts.
- Both the public and private sector partners should be prepared to take calculated risks when entering into PPPs.
- PPPs should be viewed as long-term initiatives as the real value of the partnership is delivered over time.

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