PUBLIC PRIVATE PARTNERSHIPS—BEYOND PROCUREMENT: A CASE STUDY

David Ó Muineacháin*

ABSTRACT. This paper examines the contextual background to the Public Private Partnership (PPP) process and asks if the inclusion of procurement professionals in the PPP team could enhance the process. As most PPPs fall below expectations, the question arose as to why, in the Irish Model, procurement was not included until stage 3 of the process. It was found that there was a consensus that the inclusion of procurement professionals from the commencement could benefit the process. The methodology is based on a quantitative questionnaire followed up with a number of in-depth qualitative interviews.

INTRODUCTION

The research is aimed at assessing the impact of the National Development Finance Agency’s (NDFA) Public Private Partnership (PPP) model on the procurement process in the public sector in Ireland. It is focused on public sector procurement and any implications for the health sector. The paper presents some of the initial findings of the research. It focuses on the current PPP process being employed within the public sector in Ireland. A number of other mini-case studies have also been carried out. The resultant data presented here is based on both the current data being collected and secondary data from organisational documents and published documents.

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In 2002, Spackman looked specifically at the British approach citing “Subsequent work by the National Audit Office (2001b), found that, in a sample of about 100 PFI (Private Finance Initiative) projects, most of those that were rated ‘excellent’ at time of contracting, and a third of those rated ‘good’, fell below expectations in their early years, and none exceeded expectations (expectations of those rated ‘satisfactory’ or ‘marginal’ were on average fulfilled). Thus, initial comparisons of PFI options with the more familiar publicly-financed options may be optimistic (Spackman, 2002).

Further work in public sector PPPs has been carried out in Australia, Germany, the USA, Uganda, New Zealand and Switzerland. Little work has been done in documenting the Irish Public Health sectors PPPs even with the large number of reports issued on the restructuring of the service. The first and only health sector PPP for the National Paediatric Hospital is still in its infancy.

BACKGROUND

According the Irish government’s NDFA (National Development Finance Agency) the four stage “Allocation of Responsibilities” model consists of: Stage 1 - Project Initiation, Stage 2 - Approval & Planning, Stage 3 - Procurement Process, and Stage 4 - Delivery Stage.

Stage 1 - Project Initiation comprises outline business case, objectives, ppp assessment, budget and risk, policy issues and the start of the consultation process.

Stage 2 - Approval and Planning comprises output specifications set and PSB approval (public sector benchmark for a PPPP-public private partnership project).

Stage 3 - Procurement Process comprises market soundings, info memo, project agreement, and invitation to tender followed by all the stages of a tender through to contract award.

Stage 4 - Delivery Stage comprises monitoring of delivery, sign-off at key points, commissioning, and hand back.

This paper argues that the procurement process must start at the very beginning of Stage 1. Market soundings must be in play in order to prepare the Outline Business Case – if the market research is not
complete, how can the options be weighed up?; the Budget – again the options could lead to varying costs; and even the PSB Approval – how can this be sought without seeing the full picture. It further explores two additional stages not evident in the NDFA Model.

Stage 5 – The Long Term Management of the contract.

Stage 6 – Decommissioning / Disposal post contract (the polluter pays principal).

FIGURE 1
National Development Finance Agency Model

RESEARCH APPROACH

The methodology chosen is to combine both quantitative and qualitative methods – this offers the facility to triangulate results. Baily and Farmer (1978) said of preparation for negotiation “A useful rule of thumb, adopted by many experienced negotiators, suggests that for every hour spent in negotiations, six should have been spent in preparation. No matter how well you perform during the meeting phase, unless your preparation has been at least adequate, you will probably under-achieve.” Public Private Financing of projects was only in its infancy at that time and in fact the first “Public Financed Initiatives” only really commenced in the UK from 1992 onwards. This aspect merits attention, in that it is this very element – preparation / market soundings that need to be addressed from the earliest stage of the process.

The principal criteria for both quantitative and qualitative research are; reliability, replication / replicability, validity, and generalisation: Both quantitative and qualitative reliability is assured by the consistency and accuracy of the methods / processes used. Replication and replicability relate principally to quantitative research. This is replicable across all PPPs as this exercise concerns the process and not the product. Indeed the fear of contamination by the researcher may be advantageous “The fact that behaviour and attitudes are often not stable across contacts and that the researcher may play an important part in shaping the context becomes central the analysis. Indeed it is exploited for all it is worth” (Hammersley & Atkinson, 1995). Research on issues regarding PPPs in the UK, Germany, USA, New Zealand, Uganda, Australia and Switzerland has provided the information to prepare the questionnaire. Both quantitative and qualitative validity require that every step in taken to ensures that interpretations of either data or interview are trustworthy. Johnson et al alluded to healthy scepticism. This is central to all findings, either from the questionnaire or at interview (Johnson, Duberley, Close, & Cassell, 1999). Both quantitative and qualitative findings can be generalised and will, copper fasten any wider implications.

This paper examines the contextual background to the PPP process and asks if the inclusion of procurement professionals in the PPP team could enhance the PPP process. This may then lead to change and improvement.
No work has been done in documenting the Irish Public Health Sector PPPs even with the large number of reports issued on the restructuring of the service. Little is documented on other Irish Public Sector PPPs. Work has been carried out in the area of PPP in the public sector abroad. This work builds on the context of value for money. Focus on the Irish public sector is beginning, but at present there is limited research in this area.

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<th>Authors</th>
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<td>Reeves &amp; O'Sullivan, 2001</td>
<td>Ireland</td>
<td>Public Sector - Infrastructure</td>
<td>The jury is out on whether partnership can deliver on government goals better than traditional procurement and thus highlights the need for much greater debate about the role of procurement in PPPs and in the delivery of important public services in Ireland.</td>
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<td>Hurst &amp; Reeves, 2004</td>
<td>Ireland</td>
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<td>While close attention was paid to the allocation of risk and the initial indications are that risks were allocated fairly. However, the evidence indicates that PPPs have not resulted in significant innovations and the public sector has failed to provide any evidence of value for money.</td>
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<td>English &amp; Guthrie, 2003</td>
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<td>Control was with their Department of Finance, but the authors were unsure if other influences were not in play.</td>
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<td>Wettenhall, 2003</td>
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<td>“……… the public sector can hold its own in all its new intersections with the private sector”.</td>
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<td>Batran, Essig, &amp; Schaefer, 2005</td>
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<td>“Taking into account that PPPs offer for the first time changes in the “role” of the public sector, the whole public value chain comes into new public management focus”.</td>
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<td>Essig &amp; Batran, 2005</td>
<td>Germany</td>
<td>Economic and legal decision process of PPPs</td>
<td>“Management is more difficult, with competing priorities which cannot be balanced completely”.</td>
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<td>Charles (2006)</td>
<td>Uganda</td>
<td>Public Sector – Infrastructure</td>
<td>“PPPs are complex ventures and require knowledge of the markets as well as the technical knowledge of the infrastructure and service by both the public and private partners; however both seem to lack such”.</td>
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<td>Schaeffer &amp; Loveridge (2001)</td>
<td>United States of America</td>
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<td>“Public and private organizations have such different powers and capabilities that it is difficult to perceive them as equals. Co-operators often fall into the trap of being co-opted or feeling a loss of authority as the PPC develops, signalling a need to renegotiate or end the PPC”.</td>
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<td>Baker (2003)</td>
<td>United States of America</td>
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<td>“There are higher levels of risk that are associated with all procurement partnership efforts and these must be recognized and managed in ways that guard against partnership failure”.</td>
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<td>Lawther &amp; Martin (2005a)</td>
<td>United States of America</td>
<td>Public Sector</td>
<td>“However, PPPs are not for the ‘faint of heart’. PPPs take government procurement and contracting professions out of their comfort zones and require a great deal of individual discretion”.</td>
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<td>Lienhard (2006)</td>
<td>Switzerland</td>
<td>Public Sector</td>
<td>“…the success of PPP projects depends upon a series of important factors. Included in these is the standardisation of the procedures for examining PPP feasibility, as well as the management of a PPP”.</td>
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<td>Edwards &amp; Shaoul (2002)</td>
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<td>“..The absence of systematic monitoring, review and reporting of individual projects raises questions about the value of the partnership policy for public service delivery”.</td>
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<td>Spackman (2002)</td>
<td>United Kingdom</td>
<td>Public Sector</td>
<td>“PFI has produced better-defined contracts, better contract management, and design innovation. It also incurs extra costs, in senior staff time,”</td>
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consultancy and legal fees, tendering costs, new risks, etc. Where the balance between, these benefits and costs lies, to date, will never be known”.

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<td>Parker &amp; Hartley, 2003</td>
<td>United Kingdom</td>
<td>Public Sector - Defence</td>
<td>“…the costs and benefits of PPPs must be carefully balanced against the costs and benefits of more traditional forms of public sector procurement”.</td>
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<td>Broadbent &amp; Laughlin, 2003</td>
<td>United Kingdom</td>
<td>Public Sector</td>
<td>“…many research questions remain unanswered”.</td>
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<tr>
<td>Zitron, 2006</td>
<td>United Kingdom</td>
<td>Public Sector</td>
<td>“…PPP is being hampered by the public sector’s lack of understanding of how potential private sector bidders view contracts”.</td>
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**DISCUSSION**

The literature demonstrates (Baker, 2003; Batran et al., 2005; Broadbent & Laughlin, 2003; Charles, 2006; Edwards & Shaoul, 2002; English & Guthrie, 2003; Essig & Batran, 2005; Hurst & Reeves, 2004; Lawther & Martin, 2005a; Lienhard, 2006; Newberry & Pallot, 2003; Parker & Hartley, 2003; Reeves & O'Sullivan, 2001; Schaeffer & Loveridge, 2001; Spackman, 2002; Wettenhall, 2003; Zitron, 2006) that there is widespread enthusiasm for PPPs but that there is also concern regarding aspects of the PPP process. Here the paper will focus on where and how procurement is perceived by the academics in the countries already alluded to, and also how the interviewees responded.

In Australia, Broadbent and Laughlin argue that ultimate PFI outcomes depend not only on macro-economic issues, but also on how the PFI is executed at the procurement of services side (micro-) organisational level, that is, in the decisions and actions taken by a variety of actors involve with PFI… to consider whether, and how, the context of macro-economic and other requirements impinge on the expression of PFI at the procurement (organisational) level. An emphasis on the balance sheet treatment might suggest that the macro-economic emphasis is dominant. Alternatively, a focus on risk transfer and VFM suggests that the micro-emphasis is the driver… currently, for all intents and purposes at the micro-organisational or procurement level, state governments and their proxies [NDFA in Ireland] are the sole agenda
setters, rule makers, implementers, benefactors, regulators and evaluators of the PFP they enter into (English & Guthrie, 2003).

In Germany the importance of professional procurement participation is supported by Essig and Batran in their paper titled Public–private partnership—Development of long-term relationships in public procurement in Germany, stating “Outsourcing results in a concentration on and increased importance of supplier management and as a consequence, the growth in the role of procurement within institutions. For many years, the strategic importance of the procurement function was not recognised in either the public or private sectors. Recognition of the strategic nature of procurement has emerged very slowly” (Essig & Batran, 2005).

In the UK, several academics have written on the subject of managing PPPs. Edwards & Shaoul wrote that “….our analysis shows that, although a project fails to transfer risk and deliver value for money in the way that the public agency anticipated the possibility of enforcing the arrangements and/or dissolving the partnership is in practice severely circumscribed for both legal and operational reasons. Thus the public agency may be locked into a partnership for better or for worse. This in turn undermines the power of the purchasing authority to incentivise its partner while strengthening the contractor’s already powerful financial and monopolistic position, under circumstances where it is beyond the reach of public accountability and scrutiny. Thus, far from being a neutral policy-making decision tool, “risk transfer” disguises its potential and social consequences. This, and the absence of systematic monitoring, review and reporting of individual projects, raises questions about the value of the partnership policy for public service delivery (Edwards & Shaoul, 2002).

In the USA Lawther and Martin’s paper Public Procurement Partnerships makes reference “To achieve a successful public procurement, both public managers from the using agency and public procurement officials must first agree to work together throughout the entire contracting management process” (Lawther & Martin, 2005b).

In Ireland reference to “……over 100 projects earmarked for investment using the PPP model and there are PPP projects at various stages of procurement in sectors such as roads, public transport, education and health (Hurst & Reeves, 2004). In support of this, Reeves and O’Sullivan’s paper “Can Public Private Partnerships Deliver? The
Case of Ireland” “concludes that the jury is out on whether partnership can deliver on government goals better than traditional procurement and thus highlights the need for much greater debate about the role of PPPs in the delivery of important public services in Ireland” (Reeves & O'Sullivan, 2001).

All the cited papers continuously refer to role of procurement being vital for good outcomes in major projects, be they PPP/PFI or other. The questionnaire was couched in order to reflect this. The responses and interviews to-date unambiguously support the concept that procurement professionals should be more visible in all major projects, public or PPPs. Senior practitioners were targeted in both the private and the public sectors. On the private side, companies were selected on the basis of past success in winning a PPP, albeit as part of a consortium. On the public side, practitioners were selected on the basis of their procurement involvement in PPPs prior to NDFA take over. The NDFA is bound by statute to manage all PPP projects in excess of €30m.

Case Study Data

The questionnaire/interview responses are set out below, further indicating support for inclusion of professional procurement personnel in PPP projects.

Question 1: How easy is it to persuade experienced executives to include their own procurement professionals in major “procurements” and not to be dependant solely on the design team?

Key Findings from respondents:

- It is very important that the board have the experience of a procurement professional acting solely in their interest that can ask difficult questions and obtain the correct answers from the design teams. The design team may be following their personal agenda and not that of the board”.

- We would always include our procurement professionals in our team, and I cannot understand why the public sector would not do likewise. In the private sector we would always aim to maximise the full use of our resources.

- In the final analysis the end user is seeking the best solution in terms of cost and efficiency. Certainly they (the designers) have the overall design capability. However they need guidance and Clients must
adopt a hands-on approach when it comes to the practical day to day issues not appreciated by designers. Adopt a “hands on” approach and challenge the design!

**Question:** In the long term management of the project, should specific Key Performance Indicators (KPIs) be included to be monitored during the duration of the project? What emphasis should be given to this in the NDFA model?

**Key Findings from respondents:**

- In “Design and Build” Contracts quality during the course of construction should be carefully monitored. In order for that to occur, output specification need to be very carefully defined but also monitored and very stringent commissioning testing requirements included in the tender documentation. In “Design Build Operate and Maintain” (DBOM) Contracts the maintenance regime needs to be defined rigorously and monitored rigorously. There has been a tendency with DBOM is that the maintenance is not given the same stringent scrutiny as the design and build phase with consequent problems. The KPIs should be clearly defined and most of all should be enforced.

- Output specification need to be very carefully defined and monitored. KPIs should be clearly defined in the contract and most of all should be enforced.

- The UP (Unitary Payment) is only paid if the service is delivered and the environment is consistently to the level as defined in the output specifications at tender invitation. Achievement of the UP is based on the extensive use of KPIs.

- If a project is properly designed and specified and the designers/contractors/end user client combines their skills to develop comprehensive performance specifications, there is significant benefit to be gained. The NDFA model should address this issue from the outset and particularly at stages 2 and 3. The construction industry is bedevilled with practitioners who simply conform to rules and regulations which are uneconomic and outdated. This “don’t rock the boat” mentality costs the state millions each year.
Question: If decommissioning is included as a clause / term of the contract: what are the implications for both parties and how should it be addressed? Should the NDFA Model reflect this?

Key Findings from respondents:

- The majority of contracts now being let by the NDFA have a maximum life of 30 years. The lifetime of most building projects would be 50 years. However it is very important for the contracting/sponsoring agency, when doing their capital appraisal to include decommissioning as part of the overall budget. The danger of them including it however is, when the Public Benchmark is being prepared is that while it is included in the public benchmark model it’s not included in the PPP model, thus giving the PPP model an advantage. Decommissioning has and will become more a major burden to the party holding that responsibility.

- All PPP contracts require the asset to be capable of delivering a full quality service for every day of the PPP term and at the end of this time return of the infrastructure/asset to the public sector with many operational years of life remaining. Some contract stipulate that (say for a 25 year contract) 25 plus 5 – which means that they require the 5 years following the termination of the concession to be capital investment free for the public sector.

- The contractor will typically retain responsibility for 25 years and then hand back the facility to the employer/end-user in pristine condition. Pricing PPP projects is extremely challenging given the amount of information to be absorbed in a limited period of time. I think it would be impossible to realistically price decommissioning and if it became an obligation of contractor, the employer may pay a heavy premium, way in excess of the likely cost.

Question: When and where should risk transfer? (1) Some risks are correlated with income (2) Some risks cannot be widely spread, and (3) there are possible implications of nationalisation (Spackman, 2002).

Key Findings from respondents:

- Basically the most important thing is to try to set down what risks are apparent during a particular project. In order to do this it is essential that procurement professionals be included within the project team at the earliest possible stage. They are the people most likely to identify
the possible risks, such as design risk, procurement risk, state of the market etc. It is my belief that if risk is quantifiable and identifiable it is measurable and therefore it should be included in the documents for pricing. However allowances could be made in the project budget as opposed to the tender documentation.

- Traditionally the public sector tried to pass on as much risk as possible to the private sector. Lately the risk is being borne by the party most capable of dealing with it. Just recently British Airways Authority (BAA), in its Terminal 5 project, took virtually all the risk, thus freeing up the contractor to get on with the job and prevent the litigious nature of risk mar the way. While there was operational mayhem at the opening of the terminal, the construction was completed on time. This may well be the right way to deal with risk for large complex contracts.

- Most of the PPP risk rests with the contractor and this situation is unlikely to change as long as the financiers play a significant part in transferring the risk down the line. Assessment of the risk is the real challenge and if it can’t be properly assessed the risk premium increases. From the procurement point of view I would recommend that the risk be clearly established and then calculate the associated risk premium. This may assist in deciding who should carry the risk. However the financiers may not buy into this concept.

**Question**: Can you suggest any mechanism/s for rewarding contractors for what they can control and avoid penalising them for what they cannot control?

**Key Findings from respondents:**

- Contracts reward contractors for their control by paying them the contract sum. However a problem with rewarding contractors for completing ahead of time is it may give an incentive to breach regulations and cut corners.

- Yes, this is achieved in a PPP contract through the Payment Mechanism (PM). The PM is derived from the output specification (OS). The OS identifies precisely what the public sector requires from the infrastructure. The payment mechanism then allocates a value against each of the outputs. If the contractor fails to deliver to this measure they get a reduction in their income. Alternatively if they deliver they receive payment.
- Contractors are paid to control and they should not have responsibility for what they can’t control. Offering incentives may compromise quality, standards, good practice, specification etc.

**Question**: Where a “concession period / concession” exists, i.e. it terminates when the “revenue” amounts to a set present value; what are the pros and cons of such a concept?

**Key Findings from respondents:**

- The pros of such a concept are mainly political in that the government say that they are only paying for the cost. Once the cost has been reached plus a reasonable profit to the developer that the concession ends and it reverts to the State. However the cons are that the contractor, when pricing for the job, will increase the cost of the job which will more than make up for the loss of the concessionary period.

- If the concession period ends at a target point, effectively the contractor may lose profit. The most likely outcome is the bid price will be higher in such instances.

- The approach which I have seen usually related to the achievement of an agreed Internal Rate of Return (IRR) not a Price Variance (PV). A distinct advantage with this approach is that the PPP Company is capped out at the IRR agreed and cannot make super-normal profits. The objective of the PPP is to allocate this specific public sector risk to the private party. If they are paid out early then their operational expertise is gone.

**Question**: Design Build Operate Finance (DBOF) has its merits, but Design Build Operate (DBO) with a separate tender process for Finance may yield a more cost beneficial outcome to both parties to the process. What are your thoughts on the subject?

**Key Findings from respondents:**

- While it may yield a more cost beneficial outcome there may be problems with the financing of it. I think they could possibly explore innovative ways of raising financing by “renting”/leasing the finished product and raising the finance by means of allowing anybody who finances these over a long period being entitled to some tax relief on their investment. The profit yield will mainly be made on financing over the long period in that it gives certain cash
flows which can be hedged and can also be sold on to banks and capitalized.

- As the financing element of a PPP is a significant contributor to profit, the financing must remain totally in the hands of the contractor.

- If your shirt is on the line you tend to take a more focused interest in the project. Where finance is part of a PPP the private sector only receive payment over the period of the contract if the service is delivered – so they have to stay interested in the quality of service delivery. Undertaking a separate finance competition can have benefits but the financiers will get paid irrespective of the quality of the service provided.

- I don’t believe that a separate finance arrangement would yield cost savings. In my experience the financiers are very keen to do business with contractors and they offer very competitive deals. Contractors are in turn passing the benefit up the line to the employer.

**Question:** If there are more innovative financing solutions available, as yet untapped, which could cut the pre-contract costs- estimates of 8-12% per bidder / consortium dependant on project size – please identify (On a €30m project with 3 bidders: costs =€10.8m).

**Key Findings from respondents:**

- As the major costs of a PPP tend to be in the legal end I do not see any way for this to be reduced. It is a very inefficient way of obtaining bids. If one could introduce the equivalent of Section 23,\(^1\) Section 50s\(^2\) for the financing of public capital projects I feel at the moment that there would be no shortage of funding available. If costs are not recovered on tender “A” costs will be compounded and they will recover it at some stage. They are not in the charity business.

- While it is recognised that costs are high, it is still commercially viable to bid on PPPs. Most large companies operating within consortia may be able to sustain the hit on three bids without winning, beyond that is problematic.

- Since the introduction of PFI/PPP’s an evolution in the types and myriad of contract options are available. In the United Kingdom an approach called partnership for schools and partnership for Hospitals
undertakes the procurement of infrastructure which will deliver this over a defined time period. The successful candidate will be the contractor for all infrastructures within their geographic boundaries for a set period of time – under agreed terms and conditions. This reduces the bid costs after the initial project as standard forms are used thereafter.

- One of the major disadvantages of PPP is the cost of bidding. Typical costs run at €2 million per bid. Proven costs on an open book arrangement with a selected contractor is an option. A significant part of a contractor’s cost relates to the legal profession with teams of lawyers spending months debating issues which have been previously debated on other contracts. I would recommend that the industry agree a standard suite of PPP contractual documentation and make it obligatory for all contracting parties to adopt a standard approach. Unfortunately I don’t believe this will ever happen.

The papers/interviews/questionnaire support the hypothesis that improved preliminary research with procurement involvement, followed up by improved contract maintenance and closure will deliver better outcomes for PPPs.

In Ireland the use of the NDFA model effectively forces government departments/agencies/bodies to depend a design team in order to bring the PPP proposal to the stage where the NDFA takes over the reigns. The design teams are usually populated by quantity surveyors, engineering consultancy, architectural consultancy, agency management along with governmental department officials. It is rare that professional procurement personnel are included in such teams. Yet reference to procurement abounds throughout all the literature and ultimately each PPP is procurement. The third stage of the NDFA process could be better named the contract process. Professional procurement is required across the whole range of stages of the NDFA model.

CONCLUSION

The research work that has been carried out in the area of PPP in the public sector abroad has demonstrated that professional procurement is vital for good outcomes. The work builds on the context of value for money. VFM can be delivered by the inclusion of professional procurement in any major project from the outset. Focus on the Irish
public sector is beginning, but at present there is limited research in this area. In this context the public sector is undergoing change, more specifically the Health Sector is undergoing structural changes. Although the initial work shows that the PPPs appear efficient, but unless a strategic and structural review is carried out, they may represent expensive and inappropriate investment decisions. The conclusions contained in the published papers, the responses to the questionnaires, and the results of the interviews, confirm the hypothesis that: The Procurement Process must start at the beginning of the PPP process. Procurement Professionals must participate in the initial Market Soundings. Procurement Professionals must participate in laying out the plan for the Long Term Management of the contract. Reference to Decommissioning Costs must be factored into the budgetary process.

Given all that has been documented, and despite the procurement problems identified by interviewees, all indicated that the PPP market was still worth participating in. The lesson learned from this paper, is that public and private procurement professionals must find ways of participating in major procurement projects at the highest levels. Any procurement professional that has, or is likely to be involved, at any stage of a PPP or project of similar magnitude can learn that they have a serious contribution to make, and that only through developing their professionalism they will succeed.

The limited number of active participants in PPPs in Ireland has reduced the ability to generalise beyond this initial finding. This study lends itself to further investigation.

NOTES

1. Section 23 Type Relief provides tax relief for the capital expenditure incurred on the construction, refurbishment or conversion of rented residential accommodation.

2. Section 50 of the Finance Act, 1999 provides for a scheme of tax relief for rented residential accommodation for third level students.
REFERENCES


