

**A DECISION MODEL FOR CONTRACTING OUT LOCAL
GOVERNMENT SERVICES IN A SOUTH AFRICAN CONTEXT**

by

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SUMMARY

The dissertation proposes the following hypothesis: Can Local Government Services in South Africa be contracted out?

The challenge to Local Government in South Africa is to delivery cost effective and efficient services to all constituents with only limited resources.

This study identified one way to improve and extend the delivery of services to their constituents with potential benefits. Contracting out of the delivery of services presents a viable solution to many challenges facing Local Government in South Africa today. The critical elements for this process to proceed can be found in the political will to contract out services, acceptance from Labour and the current financial pressure on Local Authorities.

Key terms :

Contracting out ; Local Government services; Privatisation; Public / private partnerships; Management contracts; Service contracts viability; Outsourcing; Contracting in Government; Local Government; Creating small businesses.

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CHAPTER 1

IDENTIFICATION AND STATEMENT OF THE RESEARCH PROBLEM

1.1 BACKGROUND

Contracting out of Local Government services has mainly become a pragmatic response to budgetary problems. The quest for service by all communities together with the call for quality service has further exacerbated the call for drastic action.

Transforming Local Government services to private ownership holds the potential of increasing economic efficiency. Resources are likely to be allocated more efficiently and a contracted out service holds the potential for improved value and efficiency. Output is likely to be produced more cheaply and the Organisation is likely to be more market oriented with a more motivated management.

To contract out a Local Government service is however a daunting task. Each stage of this process involves balancing economic and political goals. The possibilities are dependent on the specifics of the business involved. Office bearers and politicians are approaching this daunting task with trepidation, and rightly so, for this panoply of factors should determine the institutional framework and approach to such a programme, how to structure each contracted out service, the steps that need to be taken in preparation of such a programme, and how to manage the sale and negotiations.

The model developed in this study could be used as a framework which addresses the viability of any Local Government service to be contracted out and represents a systematic and organised manner of implementing a decision to either investigate or to contract out a Local Government service.

The formulation of this model has been guided by local and international research. The model has been implemented as the official model by First National Bank of Southern Africa Ltd; to be used in the contracting out of Local Government services.

The study has been divided into 3 sections The first section deals with the identification and statement of the research problem, the second, with the literature review and the research design, whilst the last section consists of the development of the model and its application, followed by recommendations and conclusions.

1.2 PROBLEM MOTIVATING THIS STUDY

The commercial reasons for restructuring or privatising State assets were elucidated by the Ministry of Public Enterprises of the Republic of South Africa, on 25 July 1995, in the discussion document released by the Government of National Unity, on the consultative and implementation framework pertaining to State assets. In recognition of the need to achieve the objectives of The Reconstruction and Development Programme, cabinet, (Discussion document...., 1995, pp.1,2) recognised that it had to re-prioritise expenditure to ensure the efficient use of current available resources. Accordingly, there is a case for private sector involvement in the areas indicated in The Reconstruction and Development Programme (1994, p.2). The public sector may effect delivery of many of its services in partnership with the private sector.

The practical implications of wholesale restructuring or any other form of restructuring are viewed with concern by a large portion of the population of South Africa. The South African Municipal Workers Union (Business Day, 8 January 1996), has accordingly, come out strongly against Government proposals to enter into partnerships with the private sector to deliver municipal services. According to the Assistant General Secretary of the South African Municipal Workers Union, Jimmy Mohajane, the Union believed the privatisation or partial privatisation of municipal services would spell disaster for Local Government structures. According to Mr Mohajane contracting out services will mean that the delivery of services will be profit-driven and a whole range of essential services could be adversely affected. He also fears that there will be significant job losses if services are contracted out.

The opposition of Unions against contracting out is not unique to South Africa. According to Marlin (1992, p.35) unions are sensitive on the subject of contracting out for the following reasons: They believe that because of the profit motive the price tag for providing the service will increase, the standard of the service will reduce, the government will lose control and that contracting out could leave city officials vulnerable to corruption. According to Hurl (1982, p.80) unions have internationally, over the years, established themselves strongly in the public sector where the absence of the profit motive, shareholders, stock market ratings and market pressures have weakened management power in collective bargaining and correspondingly strengthened that of unions. Many trade union officials therefore oppose contracting out on principle and because they see their power-base threatened by contracting out.

The Sunday Times Business Times (July 1998, p.8) confirmed this trend by stating that the South African Government is bending over backwards to the trade unions. These actions have delayed crucial decisions on a number of privatisation issues.

According to the World Bank and International Finance Corporation (1995, p.28) reconciling the buyer's need to be free to run its own show with Government's reluctance to let go is often a key to part of the art of privatisation. The South African Government's dilemma with privatisation, according to the F&T Weekly of 28 June (1996, p.9), is that it has no choice: it has to proceed because it is deeply in debt. Government's total debt to the year-end March 1996 rose by R35,2bn to R279,8bn. This is 56,3 percent of gross domestic product of South Africa. It was reported in the Business Day of 30 April (1997, p.4) that Local Government's debt has climbed to R6,5bn in 1997 compared with the R6.02bn recorded in October 1996. The South African Government has a number of ways to respond, and privatisation or contracting out services is but one. All these diverse approaches, to respond to service and cost pressures, have at least one of the following objectives, according to Marlin (1984, p.1); namely, to provide service at a lower cost, to reduce the demand for service(s), to reduce government's service to the public without reducing citizens' demand, to raise more revenue for government's services and to increase the amount, quality, and effectiveness of government service without increasing the cost.

The Growth, Employment and Redistribution: a Macroeconomic Strategy (1997.p16) (GEAR) recognises the limited capacity of the fiscus and therefore is committed to the application of public-private sector partnerships based on cost recovery where this can practically be effected. Local Government without shedding its responsibility to provide services to the community could use contracting out as an alternative service delivery mechanism. Socio-political concerns could be addressed by the delivery mechanism, which, in turn, should contribute to Local Government's role to deliver services in the context of The Reconstruction and Development Programme.

1.3 JUSTIFICATION FOR THE STUDY

Local Government in South Africa has never before been requested to deal with such enormous challenges as at present. These challenges include the cost effective and efficient delivery of services to all its constituents within the context of limited financial and human resources. This task is exacerbated by capacity constraints within Local Government, coupled with the need for fiscal discipline. These challenges, according to the Municipal Infrastructure Investment Framework (1995, p. iii), have to be met while Local Governments are going through a period of transition, which includes the redefinition of municipal borders, the clarification of municipal roles and responsibilities, the redesigning of financial systems, as well as capacity

building among new councillors and officials. Transitional Local Government bodies were subject to yet another historic moment in South Africa - the first free and fair elections at Local Government level on 1 November 1995. The newly elected councils now have the responsibility of ensuring that the Local Government machinery works efficiently and effectively to meet the needs of their constituents and that the inequalities of the old apartheid system are redressed.

Reconstruction and Development in South Africa must, according to The Reconstruction and Development Programme (1994, p.5), focus on the people of South Africa's most immediate needs.

GEAR 1997 (p.2) states that the strategy for rebuilding and restructuring the economy is in keeping with the goals set in the Reconstruction and Development Programme. GEAR is therefore an integrated economic strategy which the South African Government will use to fully confront the related challenges of meeting basic needs, developing human resources, increasing participation in the democratic institutions of civil society and the implementation of the Reconstruction and Development Programme in all its facets.

The Reconstruction and Development Programme (1994, p.15) acknowledges that Provincial and Local Government have a crucial role in adopting and implementing national-level programmes to meet the basic needs of people.

South Africa's President Nelson R Mandela, states in the preface of The Reconstruction and Development Programme that ***"We are encouraging local communities to begin developing their own priorities"***.

The need for contracting out as a method of service delivery is best summarised by the Municipal Infrastructure Investment Framework (1995, p.30) as follows:

"Extensive contracting out for works and for some forms of service provision (operations and maintenance of community-level water and sanitation facilities, house-wiring, refuse collection, and so on) will be possible from an early stage. Indeed, this approach is already in widespread use, and enables the extension of valuable training, work experience and income earning opportunities among disadvantaged communities."

In the Discussion document by the Government of National Unity on the consultative and implementation framework for the restructuring of State assets (1995, p.1), the cabinet considered the reasons for the reorganisation of State assets and enterprises as being:

- ◆ To achieve the objectives of The Reconstruction and Development Programme, the government has to re-prioritise its expenditure to ensure efficient use of current available resources; and
- ◆ In view of the severe scarcity of resources, given the government's commitments to fiscal discipline, the public sector is faced with major new challenges in implementing The Reconstruction and Development Programme, which include:
 - Maximising existing budgetary resources;
 - Mobilising new resources;
 - Providing efficient financing mechanisms for a range of activities;
 - Re-deployment of available resources within public enterprises; and
 - Developing human resources.

In discussing the mobilising of new resources, the Government (Discussion document...., 1995, p.2) sets out that *"there is a case for private sector involvement in these areas as indicated in The Reconstruction and Development Programme white paper"*, but qualifies that private sector involvement must be carefully structured and regulated. The document (Discussion document...., 1995, p.2) goes further to state that *"in addition, the public sector may effect delivery of many of its services in partnership with the private sector"*.

Central Government accordingly recognises that there are several economic reasons for the restructuring of State assets. It also recognises that, in developing a strategy to restructure the public sector, the private sector can and will play a critical role. The role of effective corporate governance (in other words incorporating successful business principles akin to those applied in the private sector) of public enterprises is furthermore recognised (Discussion document...., 1995, p.3).

The Government of National Unity entered into an agreement, (The Draft National Framework Agreement) on 25 January 1996, with the Congress of South African Trade Unions (COSATU), the Federation of South African Labour (FEDSAL) and the National Council of Trade Unions (NACTU) to agree on a process for the restructuring of certain State assets in South Africa.

The initiative to restructure State assets is part of the process of implementing The Reconstruction and Development Programme ideals, with the main objectives of restructuring being to:

- ◆ **Increase economic growth and employment**

The economic efficiency of public enterprises must be enhanced. That will facilitate long term sustainable economic growth, which is the key to widespread economic welfare and sustainable job creation.

◆ **Meeting basic needs**

All South Africans, especially the poor and disadvantaged communities, should receive an improved level of affordable services.

◆ **Redeployment of assets for growth**

Proceeds from the restructuring process should be reinvested in assets, which will facilitate growth.

◆ **Infrastructural development by mobilising and redirecting private sector capital**

The burden on public sector financing for infrastructure is enormous and Government must mobilise and redirect private sector finance for infrastructural development, be it with international or local financing.

◆ **Reduce state debt**

Restructuring proceeds may be used along with improved financial management to reduce State debt.

◆ **Enhance competitive and efficiency of state enterprises**

The demand for development programmes in the utility sector is huge. Most of these State enterprises are heavily geared and new financing through different forms of domestic and foreign partnerships, which promotes the infusion of new capital and technology, is required.

◆ **Develop human resources**

Fair employment conditions, efficient use of training and retraining redressing previous discriminatory practices and enhancement of technical and managerial capacity should be achieved through the process.

The Draft National Framework Agreement (1996, pp.3-5) sets out the agreed upon guiding principles for restructuring which include the following:

○ **Re-orientate and enhance public sector efficiency**

The purpose of restructuring is to re-orientate and enhance the public sector's ability to meet the challenges and requirements identified by The Reconstruction and Development Programme.

○ **Legal and Regulatory**

Laws and regulations, for example, relating to labour standards,

monopolies and foreign investment should be consistent with, and designated to support the Government of National Unity's development initiative. It is critical that when dealing with essential services one should establish effective regulatory mechanisms.

○ **Labour**

Organised labour and employees should participate in policy formulation processes.

The ultimate aim of restructuring is to improve the quality of life of all South Africans and therefore the underlying approach of the parties is that restructuring should not occur at the expense of workers in State enterprises. Every effort should be made to retain employment.

○ **Historically disadvantaged groups**

Through the restructuring process wealth must be redistributed with a view to creating small, medium and micro enterprises. These enterprises should facilitate and incorporate sustainable affirmative action and application of genuine black economic empowerment principles.

○ **Macro-economic stability and growth**

It is not assumed that the transfer of assets between public and private sectors will automatically promote the objectives of growth and employment. Accordingly, the restructuring will take place within policy objectives and evaluated for its overall macro-economic effect, in respect of; savings, investment, the balance of payments, ownership, and their net effect on employment creation and growth, and its potential effect on The Reconstruction and Development Programme.

○ **Industry Sector and Enterprise Focus**

Socio-economic imperatives will be assessed and a sectoral approach will be followed with enterprise case studies being the focus.

○ **New economic projects**

Domestic and foreign investors should be encouraged to invest in new projects.

○ **Models of State asset restructuring**

Models adopted internationally are not necessarily appropriate to South African conditions and requirements.

1.4 LIMITING ASSUMPTIONS

In the course of the research design process the five steps proposed by Groenewald (1989, p.6), and Mouton and Marais (1990, pp.33,34) were taken cognizance of for the purpose of this study:

1. Formulation of the problem
2. Planning and drafting of the research programme
3. Conceptualisation and operationalization
4. Data collection and classification
5. Analysis and interpretation of data

This process consists of theoretical and technical components and they are invariably linked. In developing the proposed contracting out model the following limiting assumptions apply. Firstly, the process requires a comprehensive literature review that typifies the phenomena which is seen as representative of the international situation regarding contracting out. Secondly, strategic decisions, in formulating the model, are influenced by international theory and limited by relevant South African theory.

1.5 DEFINITIONS

There are many different definitions of contracting out, of which a few are mentioned below:

In the White Paper on Privatisation and Deregulation in the Republic of South Africa (1987, pp.10-13) it is accepted by Government that the private sector can undertake public services for activities on Government's behalf for a consideration. The public sector must, however, remain responsible for the services or activities and the fact that the taxpayer will still be paying for the services or activity must be recognised. This document emphasises that:

"Such contracting out can be justified if the public sector is not itself able to undertake the service or activity or if the private sector can perform it just as or more efficiently or economically."

The Commonwealth Secretariat (1994, p.13) has the following to say about contracting out:

"Under this type of arrangement, a private sector contractor assumes responsibility under a contract for providing a specified level and quality of public services for a fee. The main objective is to obtain the most cost-effective delivery of the service, and competitive tendering is normally used, by inviting tenders from the existing public sector organisations and potential private contractors. Since the service to be provided has to be specified in

the contract, and has to be monitored during the contract period, the contracting out arrangement is best suited to situations where the type and quality of service can be clearly defined and the demand is easily identified."

Contracting out is therefore a flexible method for introducing private sector involvement to meet limited objectives.

According to Stokes (1990, p.246) three main forms of contracting out can be identified, namely:

- contracting out specific public services, which can be described as competitive tendering for the provision of specific activities, (example - street cleaning);
- management contracts, which can be described as the introduction of private sector management into a business owned by the Local Authority;
- build-own-operate schemes, which can be described as concessions to private sector consortiums to build, finance and operate infrastructure projects.

Contracting out can also take place in the form of management buy-outs. This process, according to the Commonwealth Secretariat (1994, p.13) ***"involves the managers of the enterprise acquiring a controlling shareholding in the enterprise. It is also possible to have employees taking shares in a buy-out."***

Management buy-outs are likely to be highly leveraged with a high proportion of the purchase price being funded by borrowing, which is secured by using the assets acquired. A strong cash flow, to allow for interest and capital repayment is therefore a necessary condition for successful management buy-outs."

The Municipal Infrastructure Investment Framework (1995, pp.6,7) describes contracts for the provision of services as follows:

"Contracts under which the private sector actually takes over the operations, maintenance and possibly also investment responsibilities for infrastructure provision divide into two kinds - those in which ownership of the underlying assets remains with the Local Authority (lease arrangements and concessions), and those in which ownership of these assets passes to the private sector (privatisation)." The Municipal Infrastructure Investment Framework (1995, p.67) continues: "the difference between a lease and a concession is that in the case of a lease, the Local Authority remains responsible for raising finance and implementing new investments in infrastructure, while under a concession this responsibility passes to the

concessionaire". Concessions according to the Municipal Infrastructure Investment Framework (1995, p.68) are generally of longer duration - up to 30 years.

It would, according to Harney, (1992, p.xiii) be technically incorrect to use the word "privatisation" when only referring to "contracting out" as contracting out, although an unique form of privatisation, cannot be equated with the larger scale privatisation or restructuring of State assets programmes.

It would furthermore be far easier to use contracting out structures to create solutions for unique Local Government challenges, yet still addressing pressing socio-political concerns, resulting in cost effective and efficient services being delivered to the whole of the community, which includes the poor and the disadvantaged.

Contracting out can thus be described as nothing more than a form of privatisation where the finances are kept within Local Government with production being moved over to the private sector for a given period. Local Authorities maintain the responsibility of ensuring that the income generated for the service remains in the hands of Local Government, with Local Government paying the contractor a fixed contract fee in lieu of services rendered.

1.6 SCOPE OF THIS STUDY

Newly established South African municipalities, according to the Principals and Procedural Guidelines for Engaging Private Sector Participation in Municipal Infrastructure Service Delivery (1997, p.1), face considerable pressures to deliver better services to residents within a context of limited financial and human resources. The ultimate goal is to provide better quality infrastructural services on a sustainable basis for all South Africans. Municipalities are looking for alternative ways of delivering a quality of service to as many residents as possible over as short a period of time. The Municipal Infrastructure Investment Framework (1995, p.11) estimate the capital cost of addressing these service backlogs from R45 to R89 billion over a 10-year period. In dealing with the democratising of State and Society, The Reconstruction and Development Programme (1994, p.129) emphasises that:-

"Local Government is of critical importance to The Reconstruction and Development Programme. It is the level of representative democracy closest to the people. Local Government will often be involved in the allocation of resources directly affecting communities".

Local Government is shouldered with the responsibility of providing a sustained service delivery (including inter alia, water supply, sewage

purification, electricity, refuse removal, roads and storm water drainage, health services and emergency services) to its constituents, according to Chapter 10, Section 175(3) of the Constitution of the Republic of South Africa, 1993, and further embarks on programmes to restore, maintain, upgrade and extend networks of services.

Many Local Governments, in response to addressing the needs of their communities, have begun to explore alternative means of delivering services. Local Authorities realise that, without shedding their responsibility to ensure all constituents of services, they can work in partnership with the private sector with a view to private sector investment in services and delivery of services (Municipal Infrastructure Investment Framework, 1995, p.iv).

In discussing opportunities to establish new financing and delivery mechanisms that redress the inefficiencies and inequities of the current financing and delivery system, the Municipal Infrastructure Investment Framework (1995, p.4) sets out that, *inter alia*, past experience suggests that in order to achieve a more sustained system of financing and delivery, it will require:

"The focus on Local Government as the structure to oversee delivery and financing of services does not imply that Local Government must necessarily be the delivery agent. To ensure that communities have a choice in respect of the suppliers of urban services, Local Governments will need to explore various options. These may include contracting services to the private sector using, for example, concessions, privatisation of selected services, and utilisation of national utilities where appropriate. A spectrum of choices facilitates competition and offers consumers greater scope for receiving quality services".

The Municipal Infrastructure Investment Framework (1995, p.24) also provides a definition of a delivery mechanism:-

"a particular arrangement of central-, provincial- and local institutions (both public and private), within an identified financial framework, designed to supply, operate and maintain municipal infrastructure services in a given geographical area."

The Municipal Infrastructure Investment Framework (1995, p.26) states that newly established Local Governments face considerable pressure to deliver services to newly included enfranchised residents, within a context of limited financial and human resources. The document emphasises that Local Government show need to consider alternative ways of delivery of as high a quality of services to as many residents as possible, over as short a period as possible and yet maintain viable systems in the medium and long term. It is then recognised that this could imply changes in delivery mechanisms ranging from reforming management practices to more far reaching privatisation

arrangements and that Local Government, in particular, should weigh up political concerns against efficient and cost effective service delivery.

The Municipal Infrastructure Investment Framework (1995, p.26) outlines criteria to be followed in this process. The most important criteria are listed as efficiency, as the more efficiently resources are used, and the more precisely these services are targeted to the needs and requirements of disadvantaged groups, the greater the possible expansion of services will be.

Efficiency will be found in those institutions that run their service delivery on business-like lines, in accordance with commercial principles. This point was also emphasised by Kendal (The Star, 16 October 1995, p.12) where the following was stated:

"The only way to meet these diverse needs for all our citizens is by running municipalities on lean business-line lines.

To achieve this we must follow the rules that work for the private sector: decentralised decision-making, flatten out hierarchies, and perhaps most important of all, cut Local Authorities down to size by having them stick to their business, to ensure that the best quality services are provided with the available funds whilst leaving private sector contractors to do the rest."

According to the Municipal Infrastructure Investment Framework (1995, p.27) the second criterion is effective service delivery. Other criteria are: access to services, accountability of the service provider and sustainability of the service. The service provider should be accountable to the people it services and this could be enhanced by ensuring that the service provider does a detailed viability study and that the service is regulated in a detailed contract. The accountability of the service provider according to the Commonwealth Secretariat (1994, p.38) will be regulated by the standards set in the contract. Failure to deliver the specified standard of service can be penalised by including payment penalties in the contract. This aspect is discussed in detail in chapter 4.

One important aspect that is highlighted throughout the Municipal Infrastructure Investment Framework (1995, pp.27,28) can be summarised as follows: ***the service provider must ensure that the service is sustainable. This implies, inter alia, that sound financial practices be employed and that the levels of services that are provided are within the affordability of the end users and the service provider.***

The search for alternative service delivery implies, according to the Municipal Infrastructure Investment Framework (1995, p.29), a need for innovation which is increasingly happening according to the examples quoted. A spectrum of different models can be applied to increase efficiency and effectiveness in regards to delivery of infrastructural services by Local Authorities e.g. ring-fencing, corporatisation, lease and concession

agreements, to involvement of private sector companies, including full privatisation of service delivery. The applicability of these models varies according to the kind and level of service required and these options are expected to substantially enhance access to finance and, naturally, service delivery. It is also recognised that there is not one blueprint, hence the request for innovation.

The Department of Constitutional Development recognises the role of the private sector in the Principals and Procedural Guidelines for Engaging Private Sector Participation in Municipal Infrastructure Delivery (1997, p.1) when they state the following:

Involving the private sector mobilises capital, management capacities and technical skills. Benefits can be reaped from the introduction of new capital and private sector expertise into local infrastructure delivery, such as improvement in cost recovery, efficiency, coverage and customer satisfaction. At the same time economic empowerment of previously disadvantaged people and companies can take place. More importantly perhaps is the introduction of competitive conditions that may transform the behaviour of the entire service supply system.

1.7 CONCLUSION

It is evident from this chapter that Local Government has some harsh economic realities facing it, which include the need to generate funds for reconstruction and development, in order to extend services to all communities. This should be accomplished by providing efficient services at lower cost or the mobilisation of new and existing resources.

Local Government has to respond to these new responsibilities and the difficult challenge of how to effectively deliver services to its constituents, how to sustain such service delivery and how to suitably restructure service delivery institutions where necessary.

Contracting out not only presents a unique and innovative technique for Local Government to respond to those challenges, but is recognised as an alternative option for service delivery.

Contracting out could enhance service delivery to communities, contribute to training and the development of people, distribute equity, grant economic empowerment to the disadvantaged and address socio-political concerns. The main objective of this study is to develop a comprehensive model to be used as one method to improve service dramatically.

CHAPTER 2

CONTRACTING OUT : SOME NORMATIVE PERSPECTIVES

2.1 INTRODUCTION

The fundamental differences between the many different mechanisms of privatisation and the restructuring of State assets in South Africa, with their inherent flexibility and benefits, could be misconstrued in the emotive debate on the use of these mechanisms. Such a debate could centre on the effect of the use of these mechanisms at national level, disregarding the fact that many of these mechanisms could be applied with much success at Local Government level and yet also address many, if not all, of the socio-political concerns raised when debating the use of contracting out. In the next section, a summary of contracting out is given.

2.2 RATIONALE FOR CONTRACTING OUT

Contracting out is not a new concept. Many Local Authorities throughout the industrialised world have for years used the private sector to provide certain services (Municipal Infrastructure Investment Framework, 1995, p.68). What is new to Local Government, particularly in South Africa, is the discussion of contracting out those services which have traditionally been provided by Local Government, examples of such being: fire, ambulance, street cleaning, bus services and many more.

According to Jacobs (1993, p.1) it is widely recognised that both the cost of providing public service and the general level of expectation from the public service has been growing to a degree which is not compatible. At the same time, there is a broad general acceptance that private sector project management is capable of delivering a better-motivated, cheaper and more effective service in many areas. In addition, many government and municipal authorities have been engaged in business based on outdated concepts of the role of government. In Great Britain, the government recognised this many years ago and has divested itself of many business activities. This acknowledgement actually highlights two of the most important reasons to contract out. Greater efficiency, which results, *inter alia*, from lower cost of resources used to provide services and, greater effectiveness, due to the increased quality of outputs in relation to the requirements of the user of the service.

According to Guardiano, (1992, p.1) Local Authorities could take advantage of private sector resources and the profit motive, with city and State officials being able to ensure that public services like refuse collection, street sweeping and building maintenance services are provided at a high quality and low cost and be in a position to have new waste water treatment plants, prisons and toll-roads built and operate cost effectively.

Moore (1992, p.115), who was a minister for ten years in Margaret Thatcher's Conservative Government, stated the following:

"Privatisation has shown itself capable not only of rescuing individual industries and a whole economy headed for disaster, but also of transforming public attitudes towards economic responsibility and the concept of private property". He continues that privatisation has become an educational process by which the people of a country can grasp the fundamental beliefs and values of free enterprise. With reference to the United Kingdom's experience he listed the following reasons to privatise:

- a) improved performance and more efficient use of resources throughout the economy;
- b) the extension of individual ownership with resultant change in public attitudes; and
- c) government resumption of its proper regulatory function.

Marlin (1984, p.5) describes the main reasons for contracting out as follows:

- a) in the face of reduced funding and resources, most Local Governments have been seeking ways to reduce service costs and in many service areas private sector firms have performed as well as Local Government at a cost;
- b) candidates that favoured curbing the growth of Local Government were very successful;
- c) service productivity has become of paramount concern. By contracting out some services, Local Government can measure the productivity of their in-house employees against that of contract employees; and
- d) contracting out is a flexible service delivery option.

Pirie (1991, p.142) confirms the rationale for contracting out by stating that the general advantages are enormous. With production in the private sector, economic disciplines are reintroduced.

An entire history of restrictive practices and union-controlled services are wiped out overnight and replaced by a climate of competition.

The attempt to win the contract and to retain it when it is renewed keeps firms competitive in price and quality. Costs decrease because men and machinery are utilised efficiently.

In June 1992 the World Bank issued an in-depth report on the results of asset privatisation (Galal, Ahmed, et al. 1992). The Bank selected four countries (i.e. Chile, Malaysia, Mexico and the United Kingdom) and examined in detail three privatisations in each country. The purpose of the study was to answer the question of whether or not these privatisations made their countries better off. The eight-volume study concluded that "**Our case studies answer this study with a resounding 'Yes'**". All the sales took place between 1984 and 1988. The researchers conducted an exhaustive economic analysis of each case. In 11 of the 12 cases they found the net welfare changes to be positive, adding that "**the magnitude of the gains was substantial**". The report also assessed the impact of privatisation on all parties, including the divesting government, buyers, customers and workers. Even workers were found to benefit from privatisation with the report concluding that "**in no case in the sample did divestiture make workers as a whole worse off**".

Daley, (1994, p.9) confirms the rationale for contracting out as a way to accomplishing three important goals: saving money, improving services, and giving the public greater control over the process of governing. He continues to state that privatisation does something even more fundamental: it recasts government as more of an overseer than a provider – the guardian of the public well being instead of the source. Common (1994, p.380) confirms that privatisation of public services tends to be proposed as a market alternative or a solution to the problems of public provision. Economic factors, while being the product of policy can become an independent variable in stimulating privatisation. In other words, if resources are reduced or become unavailable for public services, contracting out may result, irrespective of ideology. According to Fryklund (1994, p.4) a carefully managed public-private partnership could produce cost savings, increased public service, double revenues and could be politically popular.

Research by the Local Government Unit of First National Bank of Southern Africa Ltd; supports the above-mentioned rationale for contracting out and confirms that substantial operational savings can be generated should services be contracted out as reflected in Table 2.1 below

Table 2.1: Operational savings should services be contracted out

ILLUSTRATIVE CONTRACTING OUT IN SOUTH AFRICA			
Function	Local Authority	Contract period	Operating Savings
Cleansing Service	Sandton Town Council	8 years	R47 (m)
Fire/Ambulance Service	City Council of Pretoria	10 years	R300 (m)

Source: *Research conducted by First National Bank of Southern Africa Ltd.*

2.3 CONTRACTING OUT IN SOUTH AFRICA

With the benefits and rationale for contracting out stated so clearly, the question can now validly be raised, Why did it not take off in South Africa in the same way that it took off in the United Kingdom?, (Pirie, 1991, p.255), Japan, (Marlin, 1982, p.5) and United States of America, (Guardino, 1992, p.3).

In 1995 the Department of Constitutional Development mandated First National Bank of Southern Africa Ltd. to develop a guide for Local Government on the alternative methods of service delivery. According to this research it was found that there are three main reasons why contracting out did not take off. Firstly, Local Authorities did not experience the same cost pressures as in other countries. Secondly, in the Local Government, existing legislation links remuneration and pensions within Local Authorities to the grade (or size) of the Local Authority. Beneficiaries of this arrangement are unlikely to welcome contracting out where it might reduce sizes of Local Authorities and consequently the basis of remuneration. The Municipal Infrastructure Investment Framework (1995, p.30) also recognises the impact of introducing contracting out on the grading of the municipalities. Thirdly, the labour unions in South Africa have up to now been opposed to any form of privatisation. The above-mentioned lead to the absence of a political will to contract out Local Government services.

2.4 ADVANTAGES OF CONTRACTING OUT

Contracting out has several interesting characteristics. Probably the most important is that contracting out allows Local Authorities to maintain responsibility for the service while not performing the service themselves. This method ensures that the income and funding of the service remains in the hands of Local Government while the payment to the contractor will normally be a fixed fee.

Pirie (1992, p.141) states that the use of contractors involves the recognition that government can still be responsible for guaranteeing a supply, even when it does not produce that supply itself. The immediate advantage to government and taxpayers is the savings, normally in the 20 - 40 per cent range.

Guardiano (1992, p.1) confirms the above-mentioned by saying that Local Authorities can take advantage of private sector resources and the profit motive. He implies that city and state officials are able to ensure that public services like garbage collection, street sweeping, building maintenance services are provided at a high quality and low cost while being in a position to have new waste, water treatment plants, prisons and toll-roads built and operated, cost effectively. De Ru (1993, pp.12,13) mentions that the challenges of a market-orientated approach have become more and more appealing. Privatisation is now seen as a form of national industrial policy - as a way of ensuring that Dutch goods and services are better able to compete in the world market in terms of quality.

Contracting out is perhaps the best method of controlling costs without sacrificing quality. Pirie (1992, p.143) says one of the most curious points to emerge from the British experience is that the governing agency can exercise more control over private contractors than it could ever manage over its own workforce. Pirie (1992, pp.151-156) renders many examples of successful contracting out operations in the United Kingdom. These vary from the testing of trucks and public vehicles and the design and construction of prisons to the wheel clamping of illegally parked cars, formerly done by the Metropolitan Police.

The advantages of contracting out are divided between personnel and cost related areas. Personnel-related advantages relate to lower cost(s), without reducing or retrenching staff, the ability to handle personnel tasks, the ability to handle other specialised tasks, greater managerial expertise and greater technical expertise. Other advantages of contracting out are, an improved decision-making environment, greater flexibility, newer equipment, greater responsiveness to citizens needs and improved incentives, (Marlin,1984, pp.6,7).

Consistent under-reporting of public sector cost is perhaps the main reason why the advantages of contracting out, especially the cost advantages, are not recognised by Local Authorities. Pirie (1991, p.144) mentions that until there is a standard form for the computation of services, some Local Authority services will doubtless continue to omit to mention realistic overhead costs for central administration, use of buildings, recruitment and personnel costs.

Another important component to successful contracting out is the acceptance by Unions that contracting out is more effective. According to Pirie (1991, p.141) the resistance by Unions and employees is weakened by the fact that private business can often give workers better opportunities and incentives. He also states that in the United Kingdom, unions have spent millions, unsuccessfully, in an attempt to curtail contracting out. The benefits of contracting out in South Africa have been evidenced in a number of cases. First National Bank of Southern Africa Ltd; and Steven Barber, the Chief Fire Officer of Benoni Fire, pioneered the concept in South Africa. Savings of R16m were generated for Benoni Town Council over a period of five years when this service was contracted out in 1991.

According to De Klerk, (The Star, 5 June 1995) the Queenstown Municipality contracted out certain functions of the Local Authority on a tender basis. Functions such as the management of the municipal swimming pool, abattoir and the market were contracted out. These departments were running at a loss to the Local Authority. Through contracting out, Queenstown not only rid itself of departments that have been a drain on its finances, but ensured a more effective service to the community. The idea of contracting out its services was not new to Queenstown. In 1992 it became the first municipality to contract out the management of water and sanitation services to a private company, Water & Sanitation Services (Pty) Ltd. This essential service was contracted out to Water & Sanitation Services (Pty) Ltd; for a 25-year period, with the company assuming responsibility for running the water and sewerage treatment plants and associated reticulation networks. The municipality retained control of quality services and tariff settings.

When the Transitional Local Council was established in 1994 and Queenstown took over two adjacent townships, services had to be rendered to 192 000 people (previously 22 000). The contract with the company was amended to ensure that services would also be rendered to these areas. Queenstown benefited financially by saving on capital outlay and stores, salaries and wages. Operational savings amounted to 17,9 per cent in the first contract year.

2.5 RESEARCH SUPPORTING ADVANTAGES

A survey conducted by Ecodata (1983, p.420) based on a careful study of eight services delivered by Los Angeles County localities, concluded that contracting out is cheaper than direct employment in seven service areas and is about the same cost in the eighth area, even with full allowance for monitoring cost. Quality did not vary significantly.

Guardiano (1992, p.3) reports that according to a 1987 report by Deloitte and Touche, a New York based accounting/consulting firm, 99 per cent of Local Governments surveyed, contract out at least one service. Guardiano continues to argue that a 1990 study by the Atlanta, Georgia based Mercer Group also found that virtually all Local Governments contracted out at least one service. Some 26 per cent or more respondents were likely to have contracted out sanitation services, solid waste collection, building maintenance, security services, towing services, management and maintenance of parking garages and grounds maintenance. The Fort Worth City Council also transferred daily management of the city zoo to a private, non-profit organisation.

Guardiano (1992, p.5) also reports on a 1989 study by the National Commission of Employment Policy which indicated that contractors cut costs primarily through fewer overheads, better equipment and higher worker productivity. In support of the Commission's results, six sources of cost savings were identified by the Local Government respondents of the Mercer Group (1990, p.2) survey, namely:

- reduced personnel and equipment needs;
- the capacity to pay only for work done;
- more work for the same dollars;
- no start-up cost;
- reduced internal workload; and
- generally fewer service problems.

An important finding of the National Commission of Employment Policy study, which reviewed the employment and wage effects for 34 Los Angeles County's city and country services privatised over 10 years, is that the savings privatisation generates do not come at the expense of employee wages, but rather from the abovementioned savings identified by the Mercer Group (1990, p.2).

Moore (1992, p.115) mentions that in the United Kingdom, privatisation has accomplished wonders. By 1979, the borrowings and losses of state-owned industries were running at about £3 billion a year. But from 1989 to 1990, companies privatised by the Thatcher government reduced the government purse by some £2 billion.

Japan has a long history of contracting out services rendered at a local level which dates back to World War II. According to Marlin (1982, p.4) the incentives for Local Authorities in Japan to contract out are to reduce the cost of Local Government, to improve services to residents, to increase public involvement in Local Government and to respond to the guidance of politicians, which for the first three reasons has prodded them to contract out. Contracting out has been so successful in Japan that this practice has since 1970 been greatly extended.

Up until now, Japan is, according to Marlin (1992, p.13), still advocating this method to improve efficiency, skills, cut costs, improve the quality of this service and reducing staff.

Wandsworth, according to Farrington and King (1994, pp.30-31), in south London reported in its reports and accounts for 1992/93 that the authority had accumulated annual savings of £89m. From the council's point of view the advantages of contracting out services have been:

- The preparation of the specification concentrates attention on strategic aims for the full contract period;
- Contractors who are not burdened by past customs and practices, which can be a dead weight, take a fresh approach.
- The need to instruct and transmit information to contractors stimulates clear thinking and focuses attention on property records.

According to First National Bank of Southern Africa Ltd; the investigations and implementation of contracting out Local Government services in South Africa confirms the findings of international research. First National Bank of Southern Africa Ltd; has been involved in investigations for contracting out various services such as Fire and Emergency services, bus service(s), fresh produce markets, water treatment, holiday resorts and various others which proved that savings of between 10 and 30 per cent can be achieved. These findings were supported where contracting out had already taken place. Pretoria City Council has, according to Erasmus (1992, p.13), contracted out their grass cutting operation and actual savings of up to 60 per cent were achieved. Benoni Town Council has contracted out its Fire and Emergency Service and savings of 15 - 20 per cent were achieved. This was confirmed by First National Bank of Southern Africa Ltd; who conducted the feasibility study and the implementation.

The widespread use of the contracting out of services and corresponding documented cost savings worldwide (Pirie, 1991, p.144, Marlin, 1982, p.14, Guardiano, 1992, p.5) as well as in South Africa (Pienaar 1992, pp.3-9) demonstrates the viability of contracting out as a viable measure for public sector project managers to maintain and extend Local Government services without increasing taxes.

Contracting out works because it harnesses the powerful incentives generated by the private sector. Moreover, it restores Local Government to pursuing its fundamental purpose, namely, governing. This it does by relieving it of tasks like refuse collection, repairing and cleaning streets, maintaining lawns and providing bus services; all of which the private sector, under control of the responsible Local Authority, can do better and more cost effectively.

2.6 DISADVANTAGES OF CONTRACTING OUT

There are disadvantages that are associated with contracting out a Local Authority department or service. Some of these disadvantages can be overcome by introducing a constructive approach that has been recognised in the international literature listed below. It is, however, important to mention that Local Authorities often divest themselves of unwanted or unprofitable services. By merely selling it or stopping to provide the service and thereby inviting the private sector to take over a service, is not a guarantee that a service will continue to be provided successfully.

Marlin (1984, p.8) mentions the following main disadvantages of contracting out. In areas of high unemployment and large disadvantaged populations, a Local Government may see itself as playing the role of employer of last resort. That role is difficult to play through contracting out. Experience in contracting out in Local Government is relatively short. Managing the contracting out process requires skills and experience. These pitfalls can however be overcome with proper management. Marlin (1984, pp.8,9) continues to list the following pitfalls which could be overcome by constructive approaches:

i. **ANTICIPATING CONTINUED GOVERNMENT INVOLVEMENT**

Perhaps the greatest pitfall for a Local Government is to withdraw from overseeing the service once it is contracted out. An important first step is training the Local Government managers well in the contracting out process.

ii. **ANTICIPATING COMPLEX SOLUTIONS**

Contracting out should not be viewed as a panacea for a variety of local service delivery problems including costs, deteriorating quality, continuous labour demands and fiscal stringencies.

iii. **PREVENTING THE PROCESS FROM BEING CORRUPTED**

The contracting out process may become the target of corruption charges. Contracting out puts the focus of corruption at a specific point, on the process itself. The absence of contracting out, however, does not necessarily imply the absence of corruption. There is no easy way to avoid corruption. The best way to avoid it is strict adherence to contracting out procedures.

iv. **ENSURING COMPETITION**

An often-cited pitfall in contracting out a service is that it leads to excessive dependence on a single private service provider. This fear can be allayed by careful preparation of the contract between the Local Authority and the Contractor and the monitoring of services to be rendered.

v. **ENSURING CONTRACTOR PERFORMANCE**

Under no circumstances should a Local Authority, by contracting out a service, relinquish control over the service.

Farrington and King (1994, p.31) reports the following disadvantages of contracting out from Wandsworth in south London:

- Losing the benefit of an integrated office and dispersal of an established team, together with the risk of losing corporate property memory which can only be prevented by the continuing presence of adequately resourced and experienced teams.
- No specification can be exhaustive – work beyond its scope requires individual negotiations with the contractor.

Prager (1994. P.183) confirms that contracting out is not a silver bullet. Long term savings will only prevail if a number of conditions coalesce:

- **Scale:** Contracting out should be considered when the contractor is either too small or too large to take advantage of optimal economies of scale, provided, of course that the contractor can capture these scale economies.
- **Scope:** Similarly, contracting out is viable when the contractor can benefit from economies of scope while the contractor cannot.
- **Organisation:** An overgrown governance structure that can be made more efficient, flexible, and responsive by shedding some government responsibilities is a clear candidate for contracting out.
- **Competition:** More of the cost savings of contracting out will be passed on to the client when the contractors, including government entities, compete for the contract. There is little advantage to be gained from turning a public service to a private monopolist.

- Managing contracting out: The cost of the contracting out process – contract design, letting, and monitoring – need to be properly calculated. Contracting out is inappropriate when the total cost of contracting out is greater than the cost of continued internal production.

The perceived risks of Local Government and the community and how these can be overcome are listed in Table 2.2 and are derived from personal experience as well as from First National Bank of Southern Africa Ltd; in contracting out services.

Table 2.2: Risk management control mechanisms when a service is contracted out

RISK	RISK MANAGEMENT MECHANISM	GENERAL GUIDELINE
1. Non-performance under contract	Terms and conditions of contract	Important to measure according to standards set
2. Non replacement of existing assets	Capital replacement programme part of contract	If assets are sold the Local Authority will ensure standards of service by enforcing capital replacement programme
3. Failure of Company	- Local Authority to service a Board of Directors - Regular financial updates - Service standards	Regular monitoring will ensure that early warning signals are identified
4. Selling of assets	Selling of assets above certain value subject to Board approval	Mainframe control over existing assets
5. Financial risk	Company to operate in terms of existing company, tax and accounting legislation and principles	Transparent accounting and business management
6. Service standards	Contract levels Contract timing	General public will be first to complain about service standard

Source: *Research conducted by First National Bank of Southern Africa Ltd.*

To summarise, contracting out might have pitfalls but international, as well as local experience, has proved that these can almost always be overcome by implementing procedures for contracting out and by entering into a comprehensive contract with the contractor.

The final element to overcome these disadvantages is to introduce a pre-planned monitoring mechanism, accepted by all parties, which could lead to penalties for the contractor should certain conditions, as set out in the aforesaid contract, not be adhered to by the contractor.

2.7 CRITERIA FOR CONTRACTING OUT

Before contracting out can be accepted as a general principle, there are usually guidelines laid down by the government to spell out criteria for contracting out.

The Department of Constitutional Development has in the Principles and Procedural Guidelines for Engaging Private Sector Participation in Municipal Infrastructure Service Delivery (1997, PP.7-10) identified the following general principals governing public/private partnerships, namely:

i. Municipality Responsibility

The engagement of the private sector in service provision does not relieve the municipality of responsibility for service provision. The municipality remains ultimately responsible for the provision of the service whether this has been delegated to a third party or not. The municipality will always remain the regulator of the infrastructure service and must monitor it closely.

ii. Service Providers Must Be Accountable to the People Served

Whether it is the public or the private sector, the organisation that is providing the service must be accountable to the people that are being served. Mechanisms that enhance accountability to the end-user must be developed.

iii. Provision of Infrastructure Must Be Sustainable

The provision of infrastructure must be undertaken in such a way that the service will be provided in a sustainable manner. This means that as the service is extended to all sectors of the population, the revenues obtained will allow for the continued operation and maintenance of the service at an agreed upon level and standard. Feasibility studies undertaken prior to the implementation of a new service delivery scheme can help ensure that the service will produce positive real rates of return and will be sustainable.

iv. Equitable Coverage

Services must be extended as fast as possible to historically disadvantaged sectors of the population. These services must be affordable to those sectors and must be sustainable. Options include multilevel services and corresponding multilevel tariffs.

This will allow for cross-subsidisation from higher income areas to lower income ones. Indeed, requirements for adherence to national policies regarding employment equity could be included in criteria for evaluation of contract proposals.

v. Service Providers Must Adhere to Sound Environmental Principles

The services need to be provided in a manner that does not cause the degradation of the environment.

vi. Technology and Capacity Building

Adequate measures must be incorporated to ensure that skills developed during the execution of the contract are transferred to individuals where applicable. This is particularly so in the case of short-term contracts. The capacity of new employees to undertake the relevant tasks must be built up to create competency. Provisions to support or subsidise corporate capacity building in order to promote the development of disadvantaged firms could be considered.

vii. Worker Displacement and other Negative Social Impact Mitigation

Displacement of current municipality employees should be minimised. Mechanisms for compensating and retaining those workers that are displaced should be incorporated into the project, and where possible, these workers should be given new opportunities. A variety of options exist for handling current employees, including transfer of workers to the private sector entity, contracting workers out for use by the private sector, worker retraining and placement in other city jobs, and provision of severance packages to those workers not wishing to participate.

viii. Procedures for Engagement of the Private Sector Must Be Transparent

The steps to engage the private sector should be taken in such a way that all the stakeholders are aware of what is being done and why. Most importantly they need to be aware of how it is being done and what the benefits will be. When it applies, established tender procedures must be strictly observed in the interests of good governance and transparency.

Transparency on the part of both local government and investors helps build sustainability. Components include the following:

* *Clarity.* Government must adopt clear procedures for awarding and operating concessions so as to get the best investor response.

* *Predictability.* The government's role in implementing its commitments predictably is important so as to encourage investor confidence. This might include, for example, undertaking tariff adjustments, or purchasing land.

ix. Competitiveness

Competition among service providers -- including the municipality itself -- is the driving force behind reasonable costs and good service. The involvement of the private sector in the opportunity to provide infrastructure services promotes competition in service provision.

Competition need not be introduced everywhere. The municipality must identify the elements of a given service that would respond best to competition. Judgements must be made about the level of risk, about basic pricing principles and methodologies; and benchmarks must be established.

x. Performance of Service Providers Is To Be Monitored

The standards of the service that is being provided should be maintained at an acceptable level. The required standard must be defined and monitored. The results of the performance evaluation must be published whether the service provider is a private or public sector entity.

xi. Service Providers Must Be Responsive to Needs and Problems of Customers

Mechanisms that allow rapid response to customer needs must be developed and introduced.

The extension of existing infrastructure networks, for example, is going to place considerable pressure on customer complaint handling systems. The introduction of the necessary support systems to accommodate these needs will be an essential prerequisite for any service provider. It is in the interests of the end users to make known what they require from the service industry and for the service providers to respond in a manner that fully meets these requirements.

xii. Stakeholders Must Participate in Decisions

Consumer participation in effective delivery of local public goods is central to community provision of service. As decisions are made regarding improvements to service delivery, municipalities must also ensure worker involvement and maintain a dialogue with organised labour. There are three keys to using participation to improve project performance: involve the beneficiaries directly; seek their early consensus on the project; and gear in additional resources from them.

xiii. Long-term Sustainability should be planned

Expansion of infrastructure to meet basic needs should be affordable to both households and municipalities, and not compromise the long-term financial viability of third tier government. Municipalities therefore will need to analyse carefully the long-term financial implications of their proposed infrastructure plans. In order to make decisions regarding the long-term affordability of different combinations of service levels, municipalities will need to focus on financial sustainability, including tariff policy and user charges, institutional capacity, and spatial efficiency.

xiv. Successful Restructuring Depends on Capacity Building

Successful restructuring of the infrastructure service delivery system will depend on significant capacity building. This strengthening should focus on: administering the delivery of services; strategic planning, financial modelling, infrastructure investment planning; assembling financial packages for projects which include loans from and contracts with the private sector; appropriate tariffs and levels of service; managing contracts and ensuring contract compliance; establishing and promoting payment for service; and re-prioritising budgets in light of new development priorities.

xv. Development Impact should be maximised

The development impact of construction projects should be maximised to the greatest degree possible. Therefore, in designing their infrastructure service delivery programs, municipalities will want to consider such factors as job creation, development of entrepreneurs, and transfer of skills to communities.

Marlin (1984, p.10) identifies other criteria which, apart from the legal constraints, must also be measured before a service can be contracted out:

- (i) **Contract enforceability** - the Local Government must be able to measure and judge the service provided in terms of the agreement;
- (ii) **Existence of private sector companies** - the private sector must be in a position to provide the required service;
- (iii) **The need for flexibility;** and
- (iv) **In some cases partial contracting out where a Local Government decides not to contract out the entire service.**

According to Fryklund (1994, p.8) there are six basic rules for contracting out:

- Contracting out should always be the answer to a question, not a premise or a goal.
- To determine if contracting out would be cost effective. Identify all of the direct and indirect costs of the current operation and the proposed contracting out arrangement.
- Do not contract out unless the expected gains of contracting out exceed the transaction costs of contracting out.
- Be aware of public policy implications of contracting out.
- The real benefits of contracting out come from leveraging private sector resources and expertise.
- Government can never contract away blame or responsibility.

Although personnel is not mentioned in the Discussion Document by the Government of National Unity on the consultative and implementation framework for the restructuring of State assets (1995), Pirie (1992, p.142) states that it is recognised by government at local and national level that forced job losses are one of the most sensitive aspects of this kind of privatisation, and that it is worth considerable effort to avoid them.

These guidelines are incorporated in the Principles and Procedural Guidelines for Engaging Private Sector Participation in Municipal Infrastructure Service Delivery (1997, p.8) as set out above in point (vii) under the heading General Principles Governing Public/Private Partnerships. In any contracting out situation, it is worthwhile to obtain the co-operation of all personnel and the only feasible way of doing this is by offering everybody a position with at least the same benefits which they enjoy at present, in the new company. The Local Government could see this incentive as positive and this could be a real incentive for staff to increase efficiency and effectiveness.

The Discussion Document by the Government of National Unity on the consultative and implementation framework for the restructuring of the State assets (1995, p.6) however states that organised labour in general and employees of the relevant public enterprises should fully participate in all policy formulation processes. In addition, the rights, obligations and standards of labour should not be adversely affected.

The Municipal Infrastructure Investment Framework (1995, p.30) states clearly that unions also will play an important role in contracting out in stating "***when opting for these models careful consideration must be given to the interest of unions and how to accommodate them in new arrangements***".

In terms of the Municipal Infrastructure Investment Framework (1995, p.26) the criteria for selecting alternative delivery mechanisms are clearly stated.

Local Governments will need to consider alternative ways of delivering as high a quality of service to as many residents as possible over the shortest period possible and yet maintain viable systems in the medium and long term. This could imply changes in delivery mechanisms ranging from reforming management practices through to more far-reaching privatisation arrangements. Local Governments will need to weigh up political concerns against efficient and cost effective service delivery. According to the Municipal Infrastructure Investment Framework (1995, pp.26,27), Local Government institutions and service providers, when assessing their performance, should do so according to the criteria set out below:

- efficiency should be adopted as an important criterion against which to assess the merits of alternative mechanisms for delivering services. Efficiency also implies that the delivery be exposed, where feasible, to competitive pressures;
- the second criterion is ensuring effective service delivery;
- improving equity in the access to service is another criterion that can be used to gauge an institution's performance. The new Local Government boundaries may force new service providers to look more closely at this consideration;
- the service provider should be accountable to the people it services;
- in order to meet the needs of consumers on an ongoing basis, the service provider must ensure that the service is sustainable;
- the standards of performance and financial viability historically achieved by the White Local Authorities cannot necessarily be expected to continue in an environment of greater complexity and greater resource scarcity. Changes in which Local Authorities have traditionally carried out the business of infrastructure delivery will need to be considered;
- the need for innovation in the organisation of service delivery, and in the allocation of responsibilities of service delivery in South Africa is clear.

2.8 PUBLIC GOODS AND CONTRACTING OUT

Opponents to contracting out often claim that contracting out is just as good as giving away the family silver. It is therefore important that the process of valuing the assets sold to the private sector is transparent and acceptable to all parties involved.

Moore (1992, p.122) mentions that price and demand are the two points around which all sales revolve. Whatever the price, critics will refuse to believe that privatisation has any purpose other than filling the state's coffers. The best advice is to ignore the critics and draw instead on lessons learned through more than a decade of actual privatisation experience in the United Kingdom.

The British experience, according to Hurl (1989, p.55), argues that family silver can be turned into gold. A treasury commissioner survey gives a figure of nearly 25 per cent of the adult population in the United Kingdom now owning shares in privatised companies. This is proof that contracting out could also be used to take the power, through shareholding, to the people or the workers in a particular company. In the United Kingdom the government devised a system in which small investors buy at a fixed price and institutions submit tenders. These mixed sales have, according to Moore (1992, p.122), been very successful.

According to section 17D of the Promotion of Local Government Affairs Act 91 of 1983, Local Authorities may acquire shares in a private company. This shareholding could be seen as a way of holding a golden share that gives the Local Government certain rights that can be used to ensure the continuation of the service at an acceptable cost. Where public goods are therefore sold to the private sector when a service is contracted out, it must be done in such a way that it will promote efficiency and effectiveness without providing unnecessary benefits to the recipient of the assets.

Hurl (1992, p.10) mentions that a public good is an externality. The benefit people get depends not only on how much they have but also on how much other people have. The term public good is not a political term but a technical term, used to suggest the characteristic that the goods are consumed collectively, (Milward, 1971, p.133).

Heilbronner, et al. (1978, p.227) attribute the following characteristics to public goods:

- i. the consumption of a public good by one individual does not interfere with its consumption by another;
- ii. no one can be excluded from the use of public goods, and
- iii. public goods can only be sullied by collective decisions.

According to Hurl (1992, p.10), any future entrepreneur should reflect for a moment on whether he/she could build a lighthouse near dangerous rocks and charge passing mariners for the service he/she offers them. How would he/she prevent "free riders", consumers unwilling to pay, because payments are so easily avoidable. Defence is one of the rare examples of a pure public good and the nuclear deterrent is only available collectively. It is therefore rare to find a pure public good. Most examples are impure public goods that have elements of private goods.

Baumol, et al (1988, p.640) summarise by saying that it is not usually possible to charge a price for a pure public good, because people cannot be excluded from enjoying its benefits. It may also be undesirable to charge a price for it because that would discourage some people from using it. For these reasons, we find government sullyng many public goods. Without government intervention public goods simply would not be provided, they say.

Milward (1971, p.136) mentions that the theory of public goods perhaps does indicate a minimum list of services which ought to be provided publicly. Heilbronner, et al. (1978, p.228) confirms that we determine the level of provision of public goods by eschewing the useless market mechanism and availing ourselves of another means of decision making for example voting. We vote for the public goods we want and because voting is a curious mechanism we sometimes oversupply ourselves with these goods and sometimes we undersupply ourselves.

Hurl (1992, p.14) states that privatisation can change the distribution of income if firms prosper after their asset sales, and the distribution of wealth if those who buy the privatised service find value in it. Heilbronner, et al. (1978, pp.228,229) continue that "privatisation" of public goods may align the production of public goods with expectations, but that many technical difficulties exist and that importantly, the idea might offend our sense of justice. There are valid arguments, they continue, and clever techniques for returning some public goods into the market fold.

The main point to keep in mind is that it is impossible to make all goods private and for the areas that should remain public, the market cannot be used to establish a desirable level of output.

Hurl (1992, p.14) mentions that there are subsidised goods and services and these are provided in a market, but their prices are not a true reflection of the cost of the factor inputs, they are lower because of grants made to them. For example sending a letter from Johannesburg to Cape Town costs a great deal more than its market price. The Municipal Infrastructure Investment Framework (1995, p.17) confirms the above-mentioned views of a public good as follows:

"Typically, public goods are goods from which people cannot be excluded if they fail to pay for them, or where consumption by one person does not impinge on the consumption of these goods by others".

The conclusion reached from the above is that pure public goods cannot be privatised. Other services can be privatised as there will be a demand for these services that could be measured. Although a community as a whole would need such a service, nothing is stopping the Local Authority to contract out such a service.

Those services contracted out are in most cases paid for by the ratepayers collectively. A good example of this is street cleaning where all ratepayers are paying for this service through their rates and taxes. By contracting out this service, it will not affect the relationship between the Local Authority and the ratepayer, mainly because the Local Authority retains the responsibility for providing the service, although a private company is providing the service on its behalf.

2.9 ALTERNATIVE WAYS TO PROVIDE SERVICE(S)

Before a Local Government official considers contracting out, they normally attempt a variety of different types of solutions to overcome deficiencies or to provide services at a lower cost. Once alternatives have run out, contracting out is considered.

According to Pirie (1991, p.36), part of the difficulties which are faced arise from the position which the public sector occupies within the political system. The structure of public monopoly often means that government must attempt to represent the interest of its electors, the consumers, as well as those of itself as producer. Since public monopolies normally signify that the consumer cannot go elsewhere if dissatisfied, government is obliged to take note of complaints and to introduce remedies on behalf of consumers. Government is then placed in an invidious position where they are required to improve the service that could consume yet more funds. The easiest response is to increase spending. In light of the amount needed for infrastructure (Municipal Infrastructure Investment Framework, 1995, p.13) this solution is becoming increasingly difficult to implement in South Africa.

Pirie (1991, pp.40-50) has identified several ways used by governments to deal with the escalating cost associated with increasing services to the community. The first is to introduce an efficiency drive in an attempt to introduce to the public sector some of the efficiency-making expertise of the private sector. The effort is commendable, but the effect it achieves is only temporary. Such campaigns tend to attain limited success only during the short period of public pressure.

The second relates to drives to eliminate waste. This tactic employed by a cost-conscious government is the initiation of procedures to identify and eliminate waste within public operations. If there really are practices that add to costs without contributing to the output, such as duplication or time wasting activities, they can be identified and removed. It is normally advantageous to employ someone from outside the Local Government environment to conduct the survey because such persons will be likely to see things that might not be obvious to insiders. Departments of the public sector often establish ways of doing things without questioning their basis.

Pirie continues by stating that the drive to cut waste often focuses on tribal items where immediate and obvious savings could be made. The more serious aim of these reviews are to trim down the administrative fat which is associated with the meat of public programmes, without cutting the service itself. As with efficiency campaigns, the drive against waste tends to achieve only temporary results. Civil servants often speak of "riding out" these campaigns.

The third tactic, according to Pirie (1991, pp. 40 - 50), is the elimination of unnecessary programmes. Government looks for areas of public sector supply rendered obsolete and unnecessary by changing social circumstances. By eliminating unnecessary services, savings can be achieved. It is often the case that no public consensus can be reached for so called unnecessary services and that the steam runs out of Government drive to identify unnecessary programmes long before it normally achieves the required savings. The fourth tactic is the policy of introducing cash limits to cut back on departmental spending. Although this tactic is effective, what they can get and not what they can save often measure politicians and bureaucrats. Centrally controlled discipline is necessary to enforce this tactic which is not normally in favour before elections.

Bureaucrats will in addition ensure that every cent of the budget is spent during a budget period, therefore taking away the incentive to save.

Should a government fail to achieve the required savings, it will be forced to look at alternative ways to fund services. These alternative methods of service delivery emphasise the involvement of new parties to government service including, but not limited to, private contractors and ratepayers helping themselves or ratepayers volunteering for government services.

Marlin (1984, pp.3,4) identifies the following alternative ways of providing government services. Firstly, the issuing of franchising a service rendered by Local Government granting exclusive rights to one or more private firms for the delivery of a service, or a portion of the service. Private firms, in terms of their contract with Local Government, will collect fees directly from customers at prices that might or might not be regulated. A typical example of this is a parking garage. This method is referred to by the Municipal Infrastructure Investment Framework (1995, p.508) as service contracts, lease or concession agreements.

The second method is the provision of a subsidy instead of providing the service itself. The purpose of the subsidy is to reduce the cost to the Local Government. The subsidy could be a full or partial subsidy. An example is Springs Bus Service which receives a partial subsidy reducing over the duration of the contract period. The Municipal Infrastructure Investment Framework (1995, p.28) identifies this as contracts for the provision of services which includes privatisation.

A third method for a Government can be provision of payments through vouchers to individuals who then purchase mandated or desired services from a range of providers. The voucher is designed to provide ratepayers with a choice among providers that will enhance competition amongst the providers of the service. The Municipal Infrastructure Investment Framework (1995) does not propose this method.

The fourth method is to take up the slack in services created by cutbacks to use the services of volunteers. Volunteers have been successfully employed under government employee supervision in schools, parks, hospitals and libraries.

The fifth method is self-help that means ratepayers assist their Local Government independently in providing public services. A good example in South Africa is neighbourhood watch patrols to increase safety.

Should any of the above-mentioned tactics not be sufficient to cut back costs or increase the service level, government normally attempts to introduce ways to alter demand. The first method is to introduce user charges for specific services such as refuse collection, fire services and water services. The end-user then has the choice if he requires a particular service as well as the quantity of the service. A second way to alter service demand is by way of regulation or deregulation. A Local Government can often use its regulatory powers to stimulate the private sector's provision of services as an alternative to undertaking the services directly. An example of this is to stimulate the use of private homes for day-care groups.

Common (1994, p.380) mentions that Valentine and Manchester identified that contracting out is only one of seven alternative service delivery approaches. The rest are : franchise agreements; subsidy arrangements; vouchers; volunteer personnel; self-help and regulatory and tax incentives.

The Municipal Infrastructure Investment Framework (1995, p.32) advocates community participation in stating the following:

"Participation increases household and community satisfaction with and ownership of projects, thereby reducing time spent later on conflict resolution. It may also impact on the willingness to pay for services".

Any Government who investigated or incorporated the above-mentioned procedures to cut costs or improve services but has not achieved their desired targets, is faced with the last option - to contract out the service and thereby reducing cost and maintaining the level of service.

2.10 ALTERNATIVE SERVICE DELIVERY MECHANISMS

There are many different alternative service delivery mechanisms available for Local Government's consideration. Each one of these mechanisms can exist in its own right or in combination with one another. Stokes (1990, p.12) mentions the following mechanisms which are frequently used:

2.10.1 User fees

A user charge is an amount received from the public for performance of specific services that have been rendered to the person charged. Well-known examples are user charges for recreation services, refuse collection and water utilities. User fees could be levied from people who will enjoy a service that will be introduced, for example additional policing services to the community.

2.10.2 Voucher system

A Local Authority can provide payments through vouchers to individuals who then purchase mandated or desired services from a range of selected providers of services. The voucher is designed to provide the citizen with a choice among those providers. By allowing individuals to pursue various options, the voucher system is viewed by its advocates as introducing competition among providers, resulting in an efficient allocation of resources.

2.10.3 Franchises

A Local Authority gives the exclusive right to one or more private firms for the delivery of a service or a portion of a service. Under a franchise arrangement, the Local Authority contracts with a private firm or firms to provide particular services at an agreed price and to specified geographic areas.

The private firm then collects charges directly from its customers. The level of charges to customers may or may not be regulated. For example, private refuse collectors may freely compete for individual residential or commercial customers while being regulated in respect of their basic rates and service levels. Similarly, private firms may own and operate local solid waste disposal sites, but be compelled to operate these sites within the constraints of government regulation. A Local Authority will often receive a fee from the franchise, which can be either a fixed amount or an amount tied by a formula to the gross or net profits or revenues of the franchisee.

Typical services franchised by Local Government are those services in which private firms can expect to make a profit, for example refuse collection, the operation of parks, restaurants or parking garages.

2.10.4 Subsidies

Subsidies are similar to voucher systems in that all or part of the cost of a service provided by the private sector is funded by Local Government grants.

Subsidies commonly fund organisations which provide homeless shelters, legal aid, teen and suicide counselling, programmes for the abused, assistance for substance abuse, hot meals programmes and homemaker services. The purpose of subsidies is to reduce the price of a public service to eligible consumers, enhance the quality of the service, or increase the availability of the service.

2.10.5 Management contracts

The simplest form of management contracts provides a means of contracting out the management of some or all of the activities of an enterprise for a fixed period to a private management company. The contract is between the Local Authority and the management company.

The Local Authority retains ownership, but management control and authority pass to the private sector. Management contracts are therefore particularly appropriate where the Local Authority wants to retain the ownership of the enterprise or activity whilst introducing a strengthened commercial management.

2.10.6 Volunteers

When services are reduced or discontinued as a result of cutbacks, Local Authorities may turn to volunteers. Volunteers have been successfully employed under Local Authorities' employee supervision in schools, parks, hospitals, and libraries. Depending upon the situation, the use of volunteers may save the Local Authority money (if volunteers perform tasks similar to those performed by paid Local Authority employees) or may provide additional services (if volunteers perform new functions). The latter approach is less likely to engender fears by public employees that volunteers threaten the existence of their jobs.

2.10.7 Build-own operate schemes

In a build-own operate scheme, according to Stokes (1990, p.12), the Local Authority transfers responsibility for designing, building, financing, operating and maintaining a major project that would normally be undertaken within the public sector, to a contractor or sponsor in the private sector. Ownership may remain in the private sector throughout the life of the project, or be transferred to the authority after a specified period or after the debt has been repaid and target equity returns were achieved - the latter is termed a build-own-operate-transfer scheme. Depending on the project, the output or services produced may be sold:

- to a Local Authority (e.g. electricity sales from a private Build-Own-Operate-Transfer scheme power station to the public utility); or
- direct to the final user (as in the case of infrastructure projects such as roads, bridges or mass transit systems).

All build-own operate schemes are governed by long term contractual arrangements, committing the private sector operator to agreed performance targets (on capital costs, completion dates, etc.) and the public sector to buying the project output or allowing user charges to be levied on customers. The construction contractors and other private investors finance and operate the project.

Any facility or service that can generate revenues through user charges is potentially suitable. Existing or potential build-own operate schemes include:

- roads, bridges and tunnels for which tolls are charged;
- railways and urban metro schemes;
- power stations;
- hospitals and clinics; and
- water supply and sewage purification works.

2.11 PARTIES INVOLVED IN CONTRACTING OUT

Based on personal experience there are internal and external decision-makers and interested parties involved in the contracting out process. It is critical to involve both the internal and external decision-makers and interested parties in the whole contracting out process. The success or failure of contracting out will depend on the people involved.

A great deal of uncertainty and fear is felt by people within the Local Authority who might be affected by the contracting out process. These uncertainties, fears and even distrust should be openly discussed and addressed with all parties throughout the process. It is important to identify which decision-makers and interested parties will be affected by the contracting out in order to draw these people into the process wherever possible.

i. Internal decision makers

Democratically elected city and town councils have the responsibility in terms of chapter 10, section 175(3) of the Constitution of the Republic of South Africa, 1993, to deliver basic services to their constituents. To contract out or not to contract out a service is a significant decision for any Local Authority.

Should the Local Authority decide to contract out a department, it is critical to ensure that the Local Authority will be part of the process and after implementation, be responsible to monitor quality service delivery in terms of a contract. The Local Authority will usually identify a Local Authority employee to monitor service standards and contract performance.

Employees

Employees have certain requirements and fears that must be addressed. Requirements normally entail more say in management decisions, a greater stake in the profits of the organisation, more attention to creative ideas, job security as well as the opportunity to earn a higher income. The Commonwealth Secretariat (1994, p.70) confirms that Employee share ownership is widely used to boost morale of employees in privatised companies and to increase productivity.

Local Authority employees, in terms of personal practical experience normally fear that contracting out will cost them their jobs or lead to a reduction in their salaries and benefits as a new company will cut excess costs in order to increase economic efficiency. Employees must be suitably informed what the contracting out process entails, as well as the benefits to them. In appropriate cases, an offer of shares, share trust or guaranteed salaries and benefits will be offered. Contracting out normally works better if the future employees support the contracting out process.

ii. External decision makers and interested parties**Community**

The communities are the end-users of any service that is provided by a Local Authority. The community should benefit from the contracting out of a department which renders services to the community by receiving a better quality service at a lesser cost, at least for the duration of the contract and any renewals thereafter, and furthermore be assured that failure of the service will not be at risk or that risks are reduced to acceptable levels. The community elected representatives (Councillors) to Town or City Councils, should ensure that the community's interests would be protected when the Local Authority decides to contract out. The councillors stand in a fiduciary position to the community that elected them.

Through the democratic mandate given to them they must govern wisely and serve the interests of the community. Ultimately, they are accountable for effective decision making and the efficient provision of services and facilities to the community.

The Municipal Infrastructure Investment Framework (1995, pp.30-33) argues vociferously that community participation has considerable political and human development benefits. Communities that are involved in the prioritisation and procedures of local government, the options for service delivery in their area, and the trade-offs between service levels and costs are in a better position to make informed choices, and to reinforce the accountability of political and private sector actors and of their own civic leaders. In addition their acceptance could ensure the long term economic viability of introducing a service even if it is through the contracting out method.

Trade Unions

International experience shows (Marlin 1992, p.35 ; Hurl, 1982, p.80, Commonwealth Secretariat, 1994, p.40) that labour unions are, in general, not comfortable with privatisation or contracting out policies and would normally oppose such policies. Labour unions in South Africa have been particularly vociferous in promoting their opposition to privatisation and to a lesser extent also contracting out. The South African Industrial Leader, April 1995, reported that Cosatu is opposed to privatisation and commercialisation. Cosatu's Assistant General Secretary Zwelinzima Vavi stated that he is determined to fight against privatisation and commercialisation. According to Vavi's perception commercialisation has led to massive job losses at the Post Office, Iscor and Eskom.

Vavi as reported in the South African Industrial Leader, April 1995, stated that privatisation is about making a profit and relegating services to a secondary role. Apart from certain ideological reasons, Labour Unions raise certain socio-political concerns which are not, in their perception, addressed by contracting out.

Table 3 below sets out some of the most pressing of these socio-political concerns and how the contracting out model, as discussed in this report, addresses them.

Table 2.3: Socio-political concerns and possible solutions

Socio-political issues	How the model addresses them
Accountability	<ul style="list-style-type: none"> • Local Authority remains accountable as principal • Control standards in contract • Contract monitoring by Local Authority • Extended service to community • Partnership with Private Sector which is subject to regulatory requirements (see below)
Transparency	<ul style="list-style-type: none"> • Investigation by independent Consultant • Tender system (if applicable) • Generally Accepted Accounting Practices • Companies Act/Tax legislation • Board Representation by Local Authority • Board Representation by Employee's Shareholders Trust • Democratic involvement of stakeholders in process
Spread of Ownership	<ul style="list-style-type: none"> • Employee Shareholders Trust • Private Sector • Local Authority
Community Participation	<ul style="list-style-type: none"> • Community elected representatives on Council • Service levels and standards in contract
Empowerment of the disadvantaged	<ul style="list-style-type: none"> • Small businesses created • Equity participation • Training • New commercial skills

Socio-political issues	How the model addresses them
Equitable Service Delivery	<ul style="list-style-type: none"> • Service delivery extended • Same standards of delivery at lower cost
Maintenance & Growth of Employment	<ul style="list-style-type: none"> • Offer to all employees • Employees guaranteed same benefits • New employment opportunities created
Protection against Market mechanism failure	<ul style="list-style-type: none"> • Non-Renewal of Contract • Buy-back option for Local Authority on Assets • Penalties for non-performance

Source: *Based on research conducted by Fist National Bank of Southern Africa Ltd.*

Shop stewards or informal leaders of employees could be represented on the working group. Informal leaders could be identified by requesting nominations from the workers, or alternatively they are often identified as the "spokesperson" for the workers. It is however imperative that approval be obtained from the workers before informal leaders are included in the working group. These representatives can add insight into employee's fears, perceptions and requirements and adds to the transparency of the process. It is crucial for the ultimate success of any contracting out project to identify all the interested parties at the outset of the investigation and to involve these parties throughout the process (Marlin, 1984, p.35). The process must be transparent and geared to establish a win-win situation for all parties who will be affected by the contracting out.

According to Eggers (1994, pp. 16-19) a 1992 Reason Research survey of the 24 largest United State cities showed that the greatest political opposition comes from public employees and their unions. Experience in the United States has demonstrated that making contracting out attractive for impacted workers is vital to achieving the political support needed to implement contracting out. It is therefore important to minimise displacements of Public sector employees and Eggers continues to suggest the following:

- To schedule contracting out within the normal rate of attrition.
- To require contractors to offer first consideration for employment

- openings to all qualified public workers.
- To offer early retirement incentives.
- Letting Local Government Departments bid on contracts.

This section has, up to now, reviewed the internal and external decision makers surrounding the contracting out decision, but one important person that requires special mention is the Local Authority's Chief Executive, normally the Town Clerk or City Manager. This person, according to Marlin (1984, p.31), normally plays an important role in the decision making process. This person's view is normally the crucial determinant of the success of contracting out. He or she will often suggest what services should be examined for possible contracting out, whether contracting out should be pursued and if so, with what vigour, the length and terms of the contract and lastly, how the services should be monitored.

2.12 IMPLEMENTATION OF CONTRACTING OUT

During this phase, the Local Government's decision to implement must be put into effect. The project organisation, based on the experience of First National Bank of Southern Africa Ltd; may take a variety of forms depending on the political sensitivity of the process and the importance of the interim decisions that have to be taken. The project organisation should be in consultation with the political leadership. The organisational structure responsible for removing the service from the Local Government, could take the form of a steering or working group consisting of all interested parties, internal and external. This working group could, if necessary, call in outside expertise to deal with specific secondary issues, for instance financial, social and legal issues.

2.12.1 Drawing up of a Contract

The key, according to personal experience, in many contracting out projects, as Head of the business Unit responsible for Government Business and Privatisation of First National Bank of Southern Africa Ltd; in contracting out services, is a comprehensive contract. This aspect is by far the most important in a contracting out project. Poor contracts often lead to failures that could have been prevented if an effective contract was in place.

The explicit contract, according to Marlin (1984, p.83) and based on the researcher's personal experience, as outlined above, begins with a properly designed description which must spell out the what, when and where of the requirements and who is responsible. The second is to determine the contract price and the method of escalation. The third aspect is the duration of the contract. The fourth, relates to all the personnel-related issues, such as the offer of employment to all staff of the Council. The fifth requirement is to agree on the method of valuation of assets to be purchased and the purchase price. The sixth requirement is the compulsory investment in new or

replacement equipment. The seventh requirement is the method that will be employed to monitor the contract and penalty clauses should this not be done. The eighth requirement is a change in circumstances clause and lastly, formal periodic meetings and information exchange must be predetermined.

In addition to the above-mentioned, conditions relating to the specific service must be included. The contract is a legal document protecting both parties that must be reasonable, realistic and have clear and enforceable provisions. The contract will also include provisions that should be implemented in case of service or company failure.

The contract should provide the methods of control and explicitly define each party's role in the management of the contract. Contract extensions beyond the initial period should never be automatic and should be based on proper exercise of the option provisions in the contract. Non-performance by the contractor should result in penalties. To eliminate misunderstanding and conflicts, terms and conditions of the contract should be fully understood by both parties before implementation of the contract. The contract will also include sections which will clarify the contractor's responsibilities, the Local Authority's responsibilities, change in circumstances and contract termination which will specify and agree exactly what will happen, for example the Local Authority might have the automatic right to purchase back the assets.

In summary, the contract can be seen as the most important element of any contracting out process and a good contract will make contract performance and monitoring that much easier.

2.12.2 Service standards

Although service specifications were briefly mentioned above, the importance of service standards warrants further discussion. Once a Local Authority identifies and agrees that a service could be contracted out, it must determine and outline specifically what the contractor needs to do, when it must be done and where it must be done. Once this is agreed upon it will be included in the contract between the Local Authority and the contractor.

Marlin (1984, pp.41,42) describes what should be included in the contract. For the contract process to function smoothly, the contract must state in complete, clear, measurable and focused terms, exactly what the Local Authority wants from the contractor. Formulation of good specifications is not necessarily easy. Ensuring that the Local Authority gets what it wants as cheaply as possible, whilst maintaining the required standards, requires a combination of financial service and negotiating art, not to mention hard work. Outputs are the preferred focus of specifications. Defining outputs means describing what the Local Authority wishes to purchase. Marlin (1984, p.42) suggests the following four criteria for evaluating the adequacy of output specifications:

(i) Completeness

Output specifications should include all significant aspects of the work.

(ii) Clarity

Output specifications should be unambiguous.

(iii) Measurability

Output measures must be specified so that the Local Authority can determine whether or not the contract has been fulfilled. Wherever possible, procedures should be built into the contract monitoring process to verify numbers collected and reported by the contractor, and to develop independent measures of contractor output.

(iv) Focus

Output specifications should be focused on, and not in conflict with, the mission of the agency and the broad goals of the Local Authority. Such mission or goal should be alluded to in the specifications and should be spelled out in the solicitation.

2.12.3 Monitoring contract performance

Monitoring and enforcement of quality must be fully explained in the solicitation. Monitoring techniques include visual inspections, laboratory tests, review of contractor reports, citizens' complaints, and surveys of citizens and other users. If quality specifications cannot be tracked and enforced, they are not worth including in the solicitation or contract. Effective contract monitoring of a service that is contracted out, is a skill that should be developed by Local Authorities. In any implementation of a contracting out project, a contract manager, who should be employed by Local Government, must be appointed to monitor and report on progress. Care must be taken to ensure that the contract manager does not declare a vendetta against the contractor because he/she is seen as unfairly favoured. (Marlin, 1984, p.44).

During the contract period, according to Marlin (1984, p,44), the contractor should be generating a variety of performance data that will serve as basis for evaluating the contractor's performance. Contract monitoring requires up to date and detailed data on the contractor's performance measured against the predetermined service specifications. Contract monitoring is not only the service specifications and the performance measurement against it, but also the view of the public of the actual service provided.

It is therefore necessary that public complaints be monitored effectively. Every complaint should be recorded with date, time, type, ward, crew and inspector. The monitoring of the contract should enable the contractor to quickly identify the problem area and the crew responsible, to enable him to take action to resolve poor performance. On renewal of a contract, the Local Authority should review the need for the service to be delivered by the contractor and the service standards required.

In summary, contract monitoring forms an integral part of implementing a contracting out project and failure to do so could often lead to dissatisfaction from ratepayers and unnecessary confrontation between the contractor and the Local Government.

2.13 INTERNATIONAL PERSPECTIVE ON CONTRACTING OUT

In the modern economic history of the world, the past few years will emerge as the period in which the total failure of centrally controlled economic systems have been proven beyond a doubt. The inability of a State controlled economy to provide growth and to improve the quality of life of its citizens speaks for itself. This lesson has been a bitter experience in many countries, particularly those of Eastern Europe and Africa. The achievements of those countries where private initiative provided the impetus for growth and advancement stands in striking contrast. The fact remains that private initiative and a market-related economic system are the only true sources of sustained economic growth and progress.

It is therefore noteworthy that there is virtually no country of significance in the world today where there is not real commitment to reducing the role of the State in the economy and to expand opportunities for private initiative and ownership. There are legions of examples which can be quoted in this regard and of which the sterling successes speak for themselves. Examples are United Kingdom, Netherlands, Japan, Malaysia, Poland, Czech Republic, Hungary, Bulgaria, Germany and the Russian Federation.

Surveys and reports have been published by independent organisations that document the growth of privatisation, Pirie,(1991, p.145); Marlin, (1984, p.8); and Guardiano, (1992 pp.3-5) help to explain its fiscal and operational significance. In addition, studies have highlighted the substantial cost savings, Marlin, (1984, p.8); Guardiano, (1992, pp.3-5) that result from competitive contracting out, comparing public with private service provision, as well as the benefits which have accrued to employees.

Gibbon (1995, p.1) states that his research proves beyond dispute that privatisation is a truly global phenomenon. Contrary to the prejudices of critics, privatisation is not some crazed obsession driven by right wing ideologues. As a method of altering the structure of economics, it has been entrenched throughout the world by governments. The Czech Minister for Privatisation Jiri Skalicky states the following (Gibbon, 1995, p.46): ***"What is at stake is nothing less than the creation of a solid foundation for freedoms which have been so arduously regained"***.

Table 2.4: Contracting out municipal services: Canada

Contracting out Municipal Services: Canada
At municipal level in Ontario several major municipal electric distribution utilities in the Toronto vicinity have indicated that they are considering the privatisation of their facilities, some of which may have a value in the \$400 - \$500 million range.

Source: Gibbon 1995 Privatisation International Ltd.

Table 2.5: Contracting out municipal services: United States

CONTRACTING OUT: UNITED STATES
Contracting out at municipal level has continued to make a major impact. The following impressive results were achieved:
* Philadelphia: Competition introduced 19 services since 1992. Annual savings amount to \$22 million.
* Indianapolis: Competition introduced 50 services since 1992. Annual savings amount to \$28 million.
* Massachusetts: Competition introduced 24 different state functions since 1991. Total savings of \$274 million.

Source: Gibbon 1995 Privatisation International Ltd.

Gibbon, (1995, p.305) reports that Stockdale stated that the Government of Australia favours contracting out as an option in most public entities, ranging from fully commercial to the core administrative units of government. The experience of contracting out in Victoria has resulted in considerable efficiency improvements.

2.13.1 World Trends

According to Jones (1992, pp.1-3), privatisation in east and central Europe and the former Soviet Republics is taking place on a scale that has never been envisaged before. It is an integral part of their overall strategies of transforming centrally planned economies into modern market based economies. Privatisation is part of the process of creating a fresh market economy with all its legal, commercial, financial and institutional infrastructure.

Private ownership and private property rights are perceived not only as the foundation of a market based economy, but also as the bedrock of a democratic civil society, with personal rights and responsibilities. Among the countries with developed privatisation programmes, Hungary and Bulgaria are committed to a market based approach selling businesses one by one for the best price.

Jones (1992, p.3) states that no give away is contemplated, except for some price discounts for employees and social security funds. Poland, the Czech and Slovak Republics, followed by Albania, Lithuania, Moldavia, Romania, the Russian Federation, Slovenia and Ukraine, favour a faster process by distributing shares widely among citizens free of charge or for a modest fee. They are more concerned with equity and speed than a windfall boost to government revenue.

In America, according to Guardiano (1992, pp.3-5) privatisation is being fuelled by a steady decline in State funding, resistance to new taxes and an increasing acceptance of user fees by the taxpayer (e.g. toll fees). The services that are thought to be the most suitable for privatisation or contracting out have included:

- Refuse collection and/or processing thereof;
- Ground and building maintenance;
- Maintenance of streets;
- Maintenance of vehicles;
- Meter reading;
- Data processing;
- Legal services.

Butler (1993, p.2) reports that public sector budgets are always under pressure. The United States is an example. A survey of 4 870 Local Authorities made by the International City Management Association found that the most significant factor inducing them to consider contracting out of local services was the internal budgetary pressure to keep the lid on costs. Over 80 per cent of the respondents cited this as a decisive factor. In second place, cited by 40 per cent of the respondents were outside fiscal pressures such as legal or constitutional restrictions against increasing taxes.

According to Butler (1993, pp.2,3) Mrs Thatcher's policy for many years was to encourage Local Authorities to contract out services, rather than to force them to tender. The experience was so positive that larger numbers of Local Governments found themselves contracting out a number of services.

After a few years it was a much less controversial affair; as in 1988, when Government compelled the remaining recalcitrant Local Authorities to put a range of services out to tender. In Great Britain, Local Authorities are now required to tender for the cleaning of streets and of buildings, for catering in schools and welfare centres and for other catering, in addition to the maintenance of grounds and vehicles. The introduction of a system of competitive tendering now requires departments of a Local Authority to tender along with the private sector for the provision of services in their area. As an example of competitive tendering, one can cite the Borough of Wandsworth in London (Beresford, 1993, pp.1-4) who contracted out their refuse collection and street cleaning operation. The officers monitoring the contract have extensive operational knowledge pertaining to the service, refuse schedules, crew productivity and most importantly, knowledge of the Borough and its sensitive areas. This expertise was deployed to ensure that the service provider performed in terms of agreed specifications and standards set out in a contract between the service provider and the Borough. Whilst the contractor stands fully accountable for the actions of its workforce, Wandsworth is responsible to monitor the contract and levy penalties for any omissions or poor performance that deviates from the specifications set out in the contract. The Wandsworth Borough meets with the contractor on a regular basis and advises the contractor, who always welcomes helpful comments. Care is exercised by the Borough never to take control and never to override to the contractor's decision. The contractor must not be able to say "but you told me to do it".

According to Beresford (1993, p.1) the Wandsworth contracting out of Cleansing Services produced £444 000 in annual saving. Pirie (1991, p.146) confirms that the United Kingdom contracting out experience has been an enormous success with immense savings to ratepayers. This is also confirmed by Hurl (1992, p.50) when he says it is not necessary to sell the family silver if contracting out can produce the desired results. According to Guardiano (1992, p.8) a 1987 Deloitte & Touche investigation confirmed that 99 per cent of Local Governments contracted out at least one service and that 80 per cent of their survey respondents said they achieved savings of 10 to 40 per cent through contracting out.

It was also noted that financial savings were reported by 100 per cent of the participants. This clearly illustrates that contracting out is a viable and attractive option.

2.14 REGULATORY FRAMEWORK

Contracting out calls for economic reforms particularly by way of deregulation and lifting barriers to entry, in order to allow market forces to dictate economic activity and thereby improve efficiency and productivity. It is normally required that when a service is contracted out that a degree of legal amendments will be required. (Commonwealth Secretariat, 1994, p.25). The Municipal Infrastructure Investment Framework (1995, pp.58,59) recognises the fact that extending delivery of services could be constrained by the existing regulatory environment:

"A potential constraint is that Local Authorities may only act in terms of the relevant legislation. This includes acts such as the Provincial Government's Act of 1981 which sets out several aspects of Provincial, Local Government relations and Ordinances, such as the Transvaal Local Government Ordinance, which sets out the powers of local authorities. Any initiatives which Local Government may wish to take which are not specifically provided for in legislation are generally ultra vires". The document continues: *"Government need to ensure that legal obstacles to partnerships are removed and promote awareness among the private sector (e.g. banks, engineering companies) and the public sector of the potential of such partnership".*

The Discussion document by the Government of National Unity on the consultative and implementation framework for the restructuring of State Assets (1995, p.6) also recognises this fact. It reports that South Africa has already begun this process by developing numerous white papers to cover the broad range of regulatory reforms and also states *"to ensure that the process of public sector restructuring is transparent and leaves no ambiguity in the implementation"*. For this reason it is essential that effective regulatory mechanisms are established.

Within the existing South African regulatory framework, the Promotion of Local Government Affairs Act 91 of 1983 (as amended) which followed the publication of the White Paper is still applicable. The White Paper encourages the systematic transfer of appropriate functions, activities or property from the public sector where services, production and consumption can be regulated more efficiently by the market and price mechanisms.

In order to provide the Local Authorities with the same form of security and control, the Promotion of Local Government Act 91 of 1983 authorised Local Authorities to acquire a shareholding in a new private company which provides a contracted out service to a Local Authority.

The Act provides for a Local Authority to form a private company and to acquire shares therein, provided that *"the main object, or one of the objects of such company shall be the performance of a function or rendering of a service which is substantially the same as a function or service which a Local Authority may legally perform or render"*.

In addition to the above-mentioned it is normally the case that a municipal service cannot be contracted out in its existing legal form. The formation of a new company with new articles of association and transfer of assets and liabilities to a new corporate entity is normally necessary.

The rights of employees and creditors, after contracting out, also need to be legally defined. The new company normally accepts responsibility for existing contracts or conditions of service with employees (i.e. pensions, medical aid, study loans, etc.). The regulatory systems or contract to monitor the services or activities to be contracted out is also normally drawn up.

2.15 CONCLUSION

This chapter has sought to highlight the importance of contracting out and the advantages that could be achieved, if implemented successfully. Contracting out should be seen as an alternative service delivery mechanism but should be carefully implemented and controlled. The rationale for contracting out services in South Africa should not differ dramatically from the reasons that led to contracting out internationally. The broad rationale for contracting out can be summarised in two words, efficiency and effectiveness. Greater efficiency resulting from lowering the cost of resources used in providing the service. Greater effectiveness means increasing the quality of the outputs in relation to needs of the user of the service.

The main objective of this study is to develop a model to be used to contract out Local Government Services. This model is described in detail in chapter 4 of this study.

Chapters 1 and 2 dealt with some background and literature review of contracting out. The next chapter explains the research methodology leading to development of the model.

CHAPTER 3

RESEARCH DESIGN AND PROPOSED RESEARCH METHODOLOGY

3.1 INTRODUCTION

The previous chapter dealt with the review of the related literature, which is an important section in the research design in order to gain new insight, to investigate and review pertinent literature into the phenomenon of contracting out. It also constitutes a crucial information source, representing qualitative data, used to develop the decision model. In this chapter the objective of the study and the research design used to achieve the stated objective of this study is explained.

3.2 OBJECTIVE OF THE STUDY

According to Leedy (1993, p.109) the sole aim of all research is to discover knowledge. Proper formulation of a problem implies that a theoretical universe is specified in such a way that two important aspects are indicated, the field of the research and the methodology in terms of which the study is to be executed, (Groenewald, 1989, p.25). The research goal provides a broad indication of what researchers wish to attain in their research. Is the aim of the project to describe, to explain, or to predict, or is the aim exploratory? Is it to evaluate some practice or programme? It is possible to distinguish between three basic types of studies: exploratory, descriptive, and explanatory studies. (Mouton & Marais, 1990, p.42.)

Mouton and Marais (1990, p.43) mention that Selltitz emphasises the methods by means of which exploratory research may be conducted:

- (i) a review of related social science and other pertinent literature,
- (ii) a survey of people who have had practical experience of the problem to be studied,
- (iii) an analysis of insight-stimulating examples.

The objective pursued in exploratory studies is therefore the exploration of a relatively unknown research area and the aims of such studies may vary quite considerably. They may be:

- to gain new insights into the phenomenon;
- to undertake a preliminary investigation before a more structured study of the phenomenon;
- to explicate the central concepts and constructs.

The best guarantee for the completion of an exploratory study is to be found in the researcher's willingness to examine new ideas and suggestions and to be open to new stimuli. The major pitfall to avoid is allowing preconceived ideas or hypotheses to exercise a determining influence on the direction or nature of the research (Mouton & Marais, 1990, p.43).

The aim of this study is therefore clearly *exploratory* and is used in this study to assist in gaining insight and comprehension as to how contracting out is implemented in other parts of the world. It includes interviews with people who have had practical experience of contracting out and pertinent literature on the subject. The objective of this study is the development of a decision model for contracting out Local Government business in South Africa which could be used not only to gain a better insight into the process but also as a model to facilitate the process. It is not the aim of this study to empirically prove the results of the model in practice.

3.3 THE RESEARCH DESIGN

As a result of the inherent openness of a qualitative approach, which is discussed in 3.3.6 below, a detailed fixed design which provides a step by step account of the research process preceding the actual study is not necessary. Rather, use will be made of an emergent design. The process used to develop the model was not a formalised approach. The model was developed during the process of finding a solution for a Local Authority, committed to contracting out a service. The building process was informed by analysing requirements, in depth situation analysis, observing the requirements, expectations in Local Authorities and the environment it operated in. It was clear in terms of the mandate from the Local Authority, what had to be achieved but the "how" emerged during the design phase. Guba and Lincoln (1989, p.175) researched the motivation for an emergent design and concluded as follows: constructivists are unwilling to assume that they know enough about the time/context frame, a priori, to know what question to ask. That is, it is not possible to pursue someone else's construction with a set of predetermined questions based solely on the enquirer's generic construction. Another way to say this is that, whereas positivists, who recognise only non-metaphysical facts and observable phenomena, and rejecting metaphysics and theism, begin an enquiry "knowing" (in principle) what they don't know, constructivists, who normally combine objects to create non-representational, often geometric objects, typically face the prospect of not knowing what it is they don't know. ...But as the design proceeds, the constructivists seek continually to refine and extend the design to help it unfold. By using the emergent design the experience of contracting out as experienced in other parts of the world was captured, thereby circumventing some of the methodological constraints cited in the critique of quantitative research.

Against this background the research design of this study was postulated in fairly broad terms. Firstly, a literature study involving a review of current literature on the subject of contracting out local government services was required.

Secondly, observation was necessary in order to make some decisions concerning the emerging research design and other methodological choices (for example the identification of key role-players, the choice of participants and data collection techniques, the formulation of interview questions etc.). Thirdly, comprehensive field notes were documented throughout the research process as suggested by Guba & Lincoln (1989, p.175).

The research design may also be described as the general form or system according to which the study is executed (Groenewald, 1989, p.43). According to Mouton and Marais (1990, p.33) the aim of a research design is to plan and structure a given research project in such a manner that the eventual validity of the research findings is maximised.

The research design, pertinent to this study, was structured throughout the research process, to best utilise available qualitative data, and to optimise the development of the model and the need for partial validation through the application of the model. The process also allowed further refining of the model. The research design best suited to meet these requirements addresses the following properties:

- (i) problem identification;
- (ii) data collection and analysis techniques;
- (iii) sources of available information;
- (iv) reliability and validity;
- (v) inductive strategy;
- (vi) qualitative research;
- (vii) the development of the model;
- (viii) the implementation of the model through case studies.

3.3.1 The identification of the problem

The identification of the problem started when First National Bank of Southern Africa Ltd; decided to become involved in the contracting out of Local Government services. The provision of this service was identified as crucial to differentiate First National Bank of Southern Africa Ltd; from other providers of banking services to the Local Government market. While being involved in setting up this department the absence of a well-developed model made it very difficult to assess the underlying risk from a customer and bank perspective.

This was the motivating factor for First National Bank of Southern Africa Ltd; to commission the development of this model.

3.3.2 Data collection and analysis techniques

The following data collection techniques were used at this stage (Guba & Lincoln, 1989. pp.151-154):

Observation

A period of time was spent with existing Local Government services in order to gain first-hand experience of the nature of the service, the size of the service, level of expected service, skills audit, resource audit and financial analysis. This information determined the level of the service to be provided as well as informing the viability of contracting out (which will be described later in this study).

Interviews

Two interviewing techniques were used, namely individual interviews and focus group interviews.

Individual interviews

Individual interviews with as many identified key role-players as deemed necessary during the observation phase were conducted by means of a basic interviewing technique. This technique, as developed by Meulenberg-Buskens (HSRC, 1991) consists of four steps (opening question, reflective summary, clarifying question and closing summary) used in various combinations with each other.

Consequently, the researcher poses only one question and then summarises what the respondent said during different stages of the interview in order to circumvent as much misunderstanding as possible. Furthermore, clarifying questions were asked in order to clarify certain words/terms used by the respondent. These interviews provided insight into the different perspectives of the above role-players with regard to the proposed contracting out of a local government service.

Focus group interviews

A number of focus group interviews (in accordance with the assessment made during the observation phase) were held with employees of a service to be contracted out. These interviews utilised the same elements as the individual interview (namely an opening question, reflective summaries, clarifying questions and a closing summary), with added information transpiring as a result of group processes. Each group consisted of 12 to 15 employees.

The use of documentation

Documentation such as newspaper reports on contracting out of local government services were collected and integrated with the data obtained thus far in an attempt to add any other nuances which resided in these sources.

This was done by comparing documentary sources with data already gathered, and then adding new information to the present study. A process of data collation and integration concluded the phase of data collection.

Data analysis

The data was analysed using the thematic approach as described by, amongst others Maso (1989), Miles and Huberman (1994) and Hughes (1994). The thematic approach includes the identification of the relationship between patterns and themes during the interview process and comparing this with a formalised body of knowledge. The thematic approach is of particular importance in identifying reasons why contracting out has not taken off in South Africa. The thematic approach has amongst other things assisted in the identification of a lack of political will to contract out services. The other, main reason, is that there was no immediate need for funds so why go through the pain of contracting out. The phase of data analysis includes some basic steps such as described by Miles and Huberman (1994, p.9)

Noting reflections or other remarks in the margins

This step involves noting aspects of the interview, which are not reflected in the transcript of the interview. Such aspects include non-verbal behaviour, for example facial expressions, general comments about the setting wherein the interview took place etc.

Sorting and sifting through this material to identify similar phrases, (what is termed in quantitative methodology) relationships between variables, patterns, themes, distinct differences between subgroups, and common sequences. This step refers to what is commonly termed 'thematic analysis' by qualitative researchers, and involves the identification of certain themes from the interviews according to which the data from these interviews will be structured and analysed. Gradually elaborating a small set of themes that cover the consistencies discerned in the database

This is the final step in the process of thematic analysis. It involves the incorporation of all the information transpiring from all the interviews into the various identified themes, as well as the creation of new themes where necessary.

Interpretation

The study was concluded with an interpretative phase during which the interviews, views and expectations were assessed. This was done according to Miles and Huberman (1994, p.9) by confronting those themes with a formalised body of knowledge in the form of constructs or theories. The interpretative phase consists of a process whereby the practical and theoretical aspects of the study are integrated in such a way as to expand the current body of theoretical knowledge on the subject of the contracting out of local government services.

3.3.3 Sources of available information

The development of the model was made possible through:

- (i) The practical experience and direct involvement of the research in various contracting out projects such as: Benoni Fire Service; the Springs Bus Service; the environmental cleansing Service Division of the Sandton Town Council; Sandton Parks, Recreation and Conservation; Springs Fire and many other fire departments; Pretoria and Akasia Marketing; Res-Q-Medic who set up a private ambulance service; Harwill Engineering who are involved in building Fire Engines; refuse removal where new emerging contractors were established; etc.
- (ii) International visits by the researcher to countries that implemented contracting out such as the United Kingdom, Netherlands, Poland, Czech Republic, Hungary and Malaysia. Interviews with international experts in those countries.
- (iii) Through the researcher serving as Director of privatised companies who are dominant players in the outsourcing of services.
- (iv) The researcher's close working relationship with the Office for Privatisation in South Africa (Mr Riaan Pienaar and other officials from the Department of Finance). The Office of Privatisation's prime responsibility was the promotion of outsourcing of services by Local Government. Although this Office reported to the Department of Public Enterprises for a short while the responsibility for outsourcing of services remained with the department of Constitutional Development.
- (v) The ability of the researcher to assess international and South African literature.
- (vi) The researcher attending international conferences dealing with privatisation and contracting out of services.
- (vii) The researcher delivering papers on the contracting out of services at many conferences and to Local Authorities throughout South Africa.

- (viii) Unpublished documents dealing with contracting out and how this was implemented locally and abroad. This source of information was critical to obtain the relevant experience of local authorities in contracting out of services.

3.3.4 Reliability and validity

Reliability and validity are aspects of methodological objectivity and hence two aspects that the researcher must endeavour to satisfy unconditionally.

Before the aspect of reliability and validity can be discussed it is important to examine the different notions of objectivity based on the Münchhausen concept of objectivity as a methodological norm (Smaling, 1987, pp.169-318).

In the Münchhausen metaphor two elements are of importance: the adventures experienced world wide and the marvellous rescue from the morass. In the English language field one speaks of bootstrapping. This refers to the story of a little boy who saved himself from a morass by pulling himself up by his bootstraps. One could therefore speak of bootstrap objectivity. But the Munchhausen tale is a little better: we can make good use of the fact that the Baron roamed all over the world. Whoever thinks that the metaphor is a poor choice because the Baron's trick is not possible in reality, must perhaps reflect that this does in fact happen in the story and further more that objectivity in an absolute sense is just as impossible. This is reflected in the mapped sentence by the conditions of the formulation of the problem and particularly of the frameworks.

The first element of the Münchhausen metaphor, the adventure experience world wide, refers to the network nature of the Münchhausen conception of objectivity as a methodological norm. This implies, among other things, to endeavour both to let the object speak and not to distort it. The network nature of the Münchhausen conception implies furthermore that all subfields received attention: one must strive for objectivity as mentality, procedure and as product. The striving to do justice to the object must of course be placed within the conditions of the formulation of problems on the one hand and frameworks on the other hand, but these conditions do not apply in the absolute sense.

The second element of the Münchhausen metaphor, the miraculous rescue from the morass, reflects the view that the methodological norm of objectivity must be viewed as a regulatory principle and not as a condition that can and must be satisfied. A misstated regulatory principle is involved here: objectivity, at least in the absolute sense, is never the case, while one must always start from the assumption, against the facts, that justice has to some extent been done to the object by being able to get anywhere near to realisation of the ideal of objectivity; one must always accept any form of foreknowledge as valid.

By combining the two core meanings and the three subfields the striving for objectivity is prevented from degenerating and overshooting the objective, through excessive one-sidedness, namely of doing justice to the object of the study. If for example objectivity is viewed exclusively in terms of standardisation or automation, or in terms of caring or openness there is insufficient guarantee that the object will be allowed to speak and not be distorted. The Münchhausen conception is an antidote against the self-destruction of the striving for objectivity. This concept makes it possible for objectivity to really serve as a methodological norm. In this study to establish a contracting out model, the following question was constantly asked: Is that really objective? That is to say: Is justice really being done to the object of study?

Reliability, according to Smaling (1987, pp. 302-318), is a methodological requirement that can be imposed on procedures (such as research processes and frameworks) so as to validate the result of research studies. The core meaning of methodological reliability is the absence of random errors.

These are errors that distort the object of study and for which no definite regularity or system is assumed. These errors are also referred to as accidental errors, although random errors need not *per se* be due to chance.

The reliability of the research and the absence of errors could be substantially enhanced by implementing the concept of repeatability. Actual repeatability of research results is under discussion where the repetitions are actually possible and there are no obstructive circumstances. The research on the feasibility of contracting out Local Government services has benefited from many repetitions using the same procedures and research processes.

Reliability in the sense of stability, consistency or repeatability of results cannot be an unconditional norm because phenomena that are not stable also need to be studied. Reliability in the absence of random errors can be an unconditional methodological norm, no matter how troublesome it is in research practice to identify, eliminate or neutralise these random errors.

The last aspect that supported the reliability and validity is the grounded theory. According to Kelle (1995, p.42) grounded theory is a method for inductive generation of sociological hypotheses and theories from empirical data. At the heart of grounded theory is a very detailed and explicit coding of text. The utilisation of both grounded theory and computers in qualitative analysis can be viewed as an attempt to enhance the often vague analysis process by making it more structured and rigorous.

3.3.5 Inductive strategy

Analysis is understood to mean the resolution of a complex whole into parts, while synthesis may be regarded as the construction of a whole out of parts. By means of analysis the constituent variables or factors that are relevant to the understanding of a phenomenon event, are isolated. By means of synthesis the relationship between these variables is reconstructed to provide an insight into the causal factors associated with the events or factors being studied. (Mouton & Marais, 1990, pp.102,103).

In all mankind's long history, we have devised only two ways to seek the unknown. One of these is by means of deductive logic, the other is by means of inductive reasoning, or what is familiarly called the scientific method. (Leedy,1993, p.109.)

In the inductive method the researcher embarks upon a research project without an explicit conceptual framework, and merely uses general and vague hypotheses or guesses to guide the research. In the deductive method the researcher embarks upon a research project with a clear conceptual framework in mind (Mouton and Marais, 1990, p.103).

In this study the inductive method was used. The input and criteria used in developing this model was mainly based on qualitative information. According to Mouton and Marais (1990, p. 103) research of this nature is far less structured. Once the data have been generated, the researcher attempts to discover relationships or patterns by means of close scrutiny of the data. The data is analysed and interpreted by means of inductive abstraction and generalisation. The eventual result is that such an approach results in a more systematic explanation or even a conceptual framework such as a typology. It should be clear that the inductive method is particularly appropriate to hypothesis studies or to studies of an exploratory and descriptive nature.

3.3.6 Qualitative research

Although the terms qualitative and quantitative are fairly commonly used, according to Mouton and Marais (1990, p.155), there is a good deal of confusion about the exact meaning of these terms. Some authors are likely to classify all research that does not contain statistics as qualitative, while others may be more inclined to agree that research in which specific methodologies or approaches are used should be regarded as qualitative. According to Leedy (1989, p.139) the nature of the data dictates the methodology. If the data is verbal the methodology is qualitative, if it is numerical, the methodology is quantitative.

The quantitative approach may be described in general terms as that approach in the social sciences that is more highly formalised, with a range that is more exactly defined, in terms of the methods used.

In contradistinction, qualitative approaches are those approaches in which the procedures are not as strictly formalised, while the scope is more likely to be undefined, and a more philosophical mode of operation is adopted. (Mouton and Marais, 1990, pp.155,156.)

The three essential components present in all research are concepts, hypotheses, and observation. Concepts can be described as the most elementary symbolic constructions by means of which human beings are able to classify and categorise their experiential worlds. In other words, concepts are collective nouns that are used to label units of experience.

In very general terms, hypotheses may be described as suppositions, expectations or statements concerning the anticipated results. Observations, in general terms, may be defined as that behaviour by means of which a researcher is able to register information from his or her environment (Mouton & Marais, 1990, p.157.).

In qualitative research various measures can be taken to enhance reliability. According to Smaling (1987, p.313) internal reliability includes the following measures: triangulation, peer examination, verbal and written evaluations that do not contain 'accidental' distortions, number checks and reasoned consensus. As far as external reliability (actual or potential repeatability, replicability or reproducibility of the research results by other independent researchers using the same working methods in the same research situation with the same research subjects) is concerned, two steps are necessary: description and explication. This according to Smaling (1987, p.313) involves precise description of the status and role that the researcher had in the eyes of the research subjects. It also involves the explication of the theoretical premises and arguments for the diverse choices made in the research process. External reliability as in the foregoing description presupposes stability of the object of research and can therefore not be an unconditional methodological norm. Description and explication are not only necessary for external reliability but are also essential conditions for intersubjective imitability, controllability and criticisability. In setting out a description of the role of the researcher, in actual contracting out investigations, supported by a detailed explanation of the theoretical premises underpinning the investigation external reliability was obtained and this previsited criticism.

In the research conducted for this study this meant that a fair number of questions posed during qualitative research did not concern causal relationships but rather descriptions and explication. This need for descriptions and explications were used extensively in the research and development of the model. In order to gain the mandate to proceed with an investigation into the viability of contracting out a service, a detailed description was given of how the researcher would go about conducting the study. This in turn was based on research conducted internationally on the theoretical and practical aspects of contracting out.

Triangulation can also be used to achieve objectivity, reliability and validity. In data triangulation two or more kinds of data sources are used for example interview data and dossiers. In method triangulation two or more research methods are used, for example two or more data-collection methods such as the questionnaire, participating observation and audio- and videotape recordings. According to Denzin (1989, p.236) triangulation is a plan of action that will raise sociologists above the biases that stem from single methodologies.

3.3.7 Models

The term model is probably one of the most ambiguous in the vocabulary of the social scientist. A variety of factors has led to the situation where model and theory are frequently used as synonyms. Mouton and Marais (1990, pp.138,139) mention that Achinstein and Gorrell state that although it is generally accepted that theories and models bear a number of important similarities the differences between models and theories are largely differences in degree. The heuristic function is the most common characteristic of models, while the explanatory function is usually attributed to theories.

The key to bear in mind, according to Mouton and Marais (1990, pp.138-139), when either studying or using models, is that they do not pretend to be more than a partial representation of a given phenomenon. The model is, therefore, used to suggest new areas of research because certain relationships and dimensions are emphasised to an unusual degree.

Accordingly Mouton and Marais (1990, p.141) conclude with Gorrell's summary of the different characteristics of models. Gorrell consistently uses the term precursive theoretical models. The reason for employing this terminology is that Gorrell wishes to indicate that most models in the social sciences (in contradistinction to those in the physical sciences) are characteristically precursors to subsequent theories. The term theoretical serves merely to distinguish the model from physical or scale models. He emphasises four characteristics of precursive theoretical models. These are:

- (1) That precursive models identify central problems or questions concerning the phenomenon that ought to be investigated.
- (2) They limit, isolate, simplify, and systematise the domain that is investigated.
- (3) They provide a new language game or universe of discourse within which the phenomenon may be discussed.
- (4) That precursive models provide explanation sketches and the means for making predictions.

The first function is part of the heuristic properties of precursive theoretical models since the model provides questions, pointers and directions for inquiry that might, if pursued, lead to a better understanding of the domain under investigation. According to Mouton and Marais (1990, p.141) as far as the second characteristic of precursive theoretical models is concerned, Gorrell maintains that the precursive theoretical model generally simplifies and systematises the domain under investigation by virtue of positing certain assumptions about the structural, causative or functional nature of the model. In the third place, models provide new definitions of scientific concepts. The fourth function of models is to provide explanatory sketches of a phenomenon.

It is obviously the case that the model, by suggesting relationships between variables, does explain the order or pattern of that phenomenon in a superficial manner. The mere fact that a given phenomenon is brought into a set of relationships with other phenomena by means of that model, does, to some extent, explain the phenomenon.

The model developed through this study is a **precursive, theoretical model** in that it aims to develop something unique, in identifying the key issues in the contracting out of services and provide a systematic approach and method thereto which can be implemented.

3.3.8 Illustration of implementation and refining of the model

The three case studies featuring in this research will illustrate the precursive characteristics of the model.

3.4 CONCLUSION

The overall objective of the proposed model is to develop a paradigm that could be used to facilitate the decision process to contract out Local Government services. The aim is to improve the efficiency and effectiveness of Local Government service delivery. The development of the proposed model is based on the foregoing research design, which forms the pillar for the development of the proposed model. This model could be used as a working document for proposed services to be contracted out. This model is currently being used by First National Bank of Southern Africa Ltd; The model is described in detail in Chapter 4.

CHAPTER 4

DEVELOPMENT OF THE CONTRACTING OUT MODEL

4.1 INTRODUCTION

The previous chapter dealt with the research objectives and research design in the development of a decision model for contracting out Local Government services in South Africa.

The challenges facing Local Government in South Africa is well documented in previous chapters and is well known but nonetheless formidable. A stable and viable Local Government in South Africa is essential for consolidating democracy, stimulating economic growth and development. Local Authorities in South Africa have a critical role to play in local economic development and in ensuring sustained service delivery to their communities.

They must drive local economic development forward, deliver efficient and affordable services and make democracy a reality for all communities.

These challenges are enormous. Many Local Authorities in South Africa are expected to make the best use of limited resources; mobilise new resources; ensure effective service delivery; identify and prioritise development needs and support community participation in local development. In order to meet these needs, many Local Authorities have begun to explore alternative ways to deliver services.

In following global trends, contracting out of services is one of the methods available to improve service delivery in their area. This approach uses the expertise, investment and management capacity of the private sector to develop infrastructure, as well as to provide affordable and efficient services for all residents. Worldwide the private sector is actively involved in the provision of infrastructure, and services.

The aim of the model developed in this chapter is to assist and inform Local Authorities on the viability of contracting out as an alternative way of providing services.

This model thus represents a more systematic and organised manner of implementing the contracting out of service. The implementation of this model could assist in:

- Delivering more effective and efficient services to residents
- Addressing the huge demand to extend services to all communities; and
- Generating financial savings as a direct result of contracting out the service.

Local and international research and local, practical experience have guided the formulation of the model. The model consists of eight major steps and will be discussed in detail in this chapter.

4.2 THE CONTRACTING OUT PROCESS

Local Government should undertake a continuous review of identifying alternative delivery methods that could benefit the end-users in terms of cost or level of service.

Should such an opportunity be identified it is important to clarify and issue a clear mandate to the people responsible to investigate the feasibility of the proposed contracting out. It is at this stage that the Local Authority should consider appointing an independent consultant who should take note of the clear mandate.

It is also not uncommon that this process could be initiated by the private sector. In this stage, the private sector should submit a comprehensive conceptual proposal that will enable the Local Government to determine the merits and uniqueness. Such proposals should normally be considered on a "first-come-first-served" basis with a view to rewarding innovativeness and ingenuity called for by the Municipal Infrastructure Investment Framework.

If the proposal meets the broad guidelines of the contracting out principles, Local Government should consider giving a letter of exclusivity to the private sector party concerned to conduct the feasibility study, as described in the model, and to submit a complete proposal to the Local Authority.

Should this proposal not be acceptable other private sector operators could be invited as well. In order to ensure that a comprehensive plan is submitted, it might be advisable to appoint an independent consultant to conduct the study in consultation with all the interested parties.

The cost of such an investigation should be born by the Local Authority or be absorbed by the private sector operator, should the proposal be acceptable to the Local Authority. For this purpose it will be necessary for Local Authorities and the private sector to budget for this process up front. The compensation for the cost of the study by the successful bidder will therefore be incorporated as one of the terms of contracting out.

In order to determine the uniqueness of a project the following criteria can be used as a general guideline:

- i) the proposal should contain a unique solution to the economic problem of providing efficient service to all communities with special reference to the needy communities;

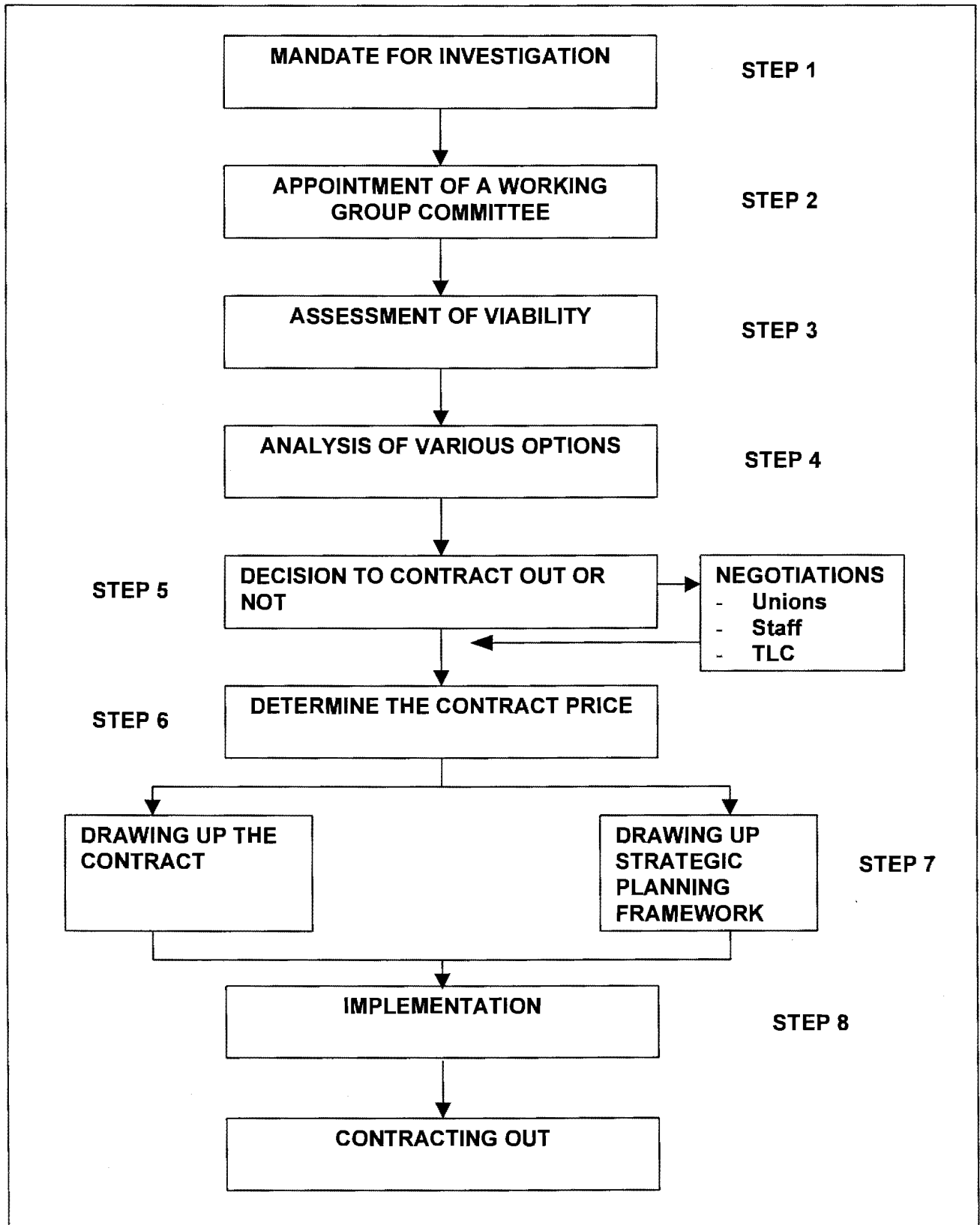
- ii) the proposal should offer a cost-effective solution which will offer potential savings to the Local Government;
- iii) the proposal should indicate how the private sector can offer the required service in view of its possession of certain skills, or patent rights, or experience which will enhance the chances of a successful contracting out;
- iv) indicating how the contracting out could link existing skills available in a department to be contracted out, in other words, the staff would form part of the contracted out service, to another component of which a private sector is already in possession. This criteria is in line with the objectives of the Skills Development Bill, (1997, p.4) which should be demand-led and based on partnerships between the public and private sector;
- v) the Local Authority should be sure that proposal is sustainable over the long term. This aspect should be tested in full during the full investigation;
- vi) the proposal should be evaluated against competition in the field if this is possible.

If no outside competition exists the only effective way to evaluate the proposal, is to compare it with the Local Authority's cost of providing the service. This will in any event be part of any feasibility study.

- vii) the proposal should highlight job creation which in the South African context can have positive political implications;
- viii) the proposal should provide access to service which could mean that the service could include some measures of cross subsidisation from the Local Authority. This means that in order to make it viable for a private sector operator to provide a service the Local Authority might decide to subsidise the service. The contractor could therefore change, by agreement, a comparable lower fee to the public. This concept was implemented in the case of the Springs Bus Service when it was contracted out.

Once this process is completed the feasibility of the proposed contracting out should be investigated in terms of the following model. A summary of the process is visualised in Table 4.1.

Table 4.1: Summary of the contracting out process



The objective of Step 1 is the initiation of the process. This presupposes that the Local Authority expresses an interest to contract out one of its departments or specific services. A mandate needs to be obtained by the consultant, as discussed above, to investigate the feasibility of the project.

Once the mandate has been given by the Local Authority, a working group needs to be appointed and the process listed hereunder follows:

Step 1: Initiation of the process

The decision to contract out is not a simple matter of pure economic efficiency. Moreover, because responsibilities are rarely legislated in a vacuum, public service production decisions often have to deal with several objectives at the same time - for example, trash collection may be designed to satisfy public health goals and an aesthetic goal of cleaner streets, while simultaneously minimising adverse environmental consequences stemming from the disposal of garbage and street litter (Wisniewski, 1992, p.101).

In the early stage the initiation of the contracting out process remains subject to political acceptability, in the sense that non-economic objectives and concerns are uppermost in peoples' minds (The World Bank and International Finance Corporation, 1995, p.19).

The best way to launch a contracting out process depends on the extent of the Government (Central and Provincial) and Local Governments strength and commitment to the process. According to the World Bank (1995, p.21), when political strength exists alongside government commitment to reform, the route to contracting out can be top-down, direct and swift. One example is Peru, where following President Fujimori's assumptions of emergency powers, a Privatisation Law was rapidly put in place by decree. The political window lasted long enough to establish a regulatory framework, demonstrated that it worked, and then they privatised.

According to the World Bank (1995, p.21) Russia, in 1991, was an example of a government whose commitment significantly exceeded its strength. The emergence of independent Russia in August 1991, following the failed coup and the collapse of the Soviet Union, marked a dramatic end to communism. In late 1991 the new government established the principles for economic recovery: to build a modern market economy, built on individual rights and responsibilities, and drastically reduce the role of the state.

The immediate need in Russia was to demonstrate to a population, suspicious of such new ideas, that privatisation was possible, could be fairly managed, and could bring real change. This meant starting bottom-up, from the grassroots level.

The above-mentioned two approaches should influence the decision of the Local Government to commence with the process. Irrespective if they will decide on top-down or bottom-up the first step is to decide on a mandate to investigate the possibility of contracting out a particular service.

For contracting out to work and to gain momentum early success in contracting out services need to be achieved. This suggest that easy candidates should be prioritised. In most cases, however, Local Government is tempted to contract out the loss makers or problem departments.

It is therefore important that the mandate to investigate is only completed after careful prioritisation within the Local Government itself, based on local conditions and considerations.

Step 2: Appointment of a Working Group Committee

The appointment of a Working Group Committee is seen as crucial to, ensure transparency and participation by all role players in the process, but to ensure that all the role players have a say in the process.

According to Marlin (1984, p.27) the local decision-making elements are influenced by numerous factors such as:

- 1) Managers' interest in cost savings;
- 2) Managers' willingness to experiment;
- 3) Availability of competitive suppliers;
- 4) Interest of elected officials.

The following groups are normally represented on a Working Group:

- a) Community - through councillors;
- b) Employees / Unions;
- c) Departmental head of service to be contracted out (and staff);
- d) Town Treasurer's Department;
- e) Personnel Department;
- f) Legal Department;
- g) Town Clerk (CEO);
- h) The new company representative;
- i) Facilitator / Consultant.

The appointed Working Group should be formed as early as possible in the process and they should understand and implement the mandate as set out in Step 1. It is also not uncommon for this working group to appoint a facilitator, consultant or advisor to assist in establishing the institutional framework and approach to the contracting out process.

The working group's task would be to facilitate the process as transparent as possible and to come up with an economic decision that would be politically acceptable and implementable.

Step 3: Assessment of viability

The first and most important task facing the working group, according to Wisniewski (1992, p102), is to determine a clear specification of the tasks to be performed and a description of the level of services to be employed in that performance.

It happens very often that the same services in different Local Authorities involves different standards or different tasks. For example, contracting out refuse collection in one Local Authority could include street cleaning while the next one only consists of refuse removal. Unless a specific level of effort or service standard is clearly identified, cost comparisons may not be meaningful.

To complete a logical and valid cost comparison, the cost of the service to be contracted out must be comparable before and after contracting out is considered. Therefore, the viability study must be based on identical work requirements and specifications.

Using common accepted measures such, as unit cost could also be misleading. Unit costs should include detail of what bundle of services is associated with the cost data. Higher costs may be warranted for a higher quality of service.

It is further important to quantify what service is required and not to specify how this should be achieved. Different methods resulting in the same level of service at the required standard could result in savings in delivering the required service.

When the Springs Town Council decided to contract out its bus service in 1993, the local schools defined the levels of service and after careful consideration the starting time of schools were changed to assist in the economically acceptable usage of the bus fleet. All the interested parties were satisfied and the private sector operator was able to introduce the required service at a profit for himself.

The assessment of viability is by far the most critical in the model and it is therefore necessary to develop a financial model to determine financial feasibility to contract out or not. This detailed feasibility study is discussed in detail in 4.3 below and forms part of the contracting out model.

Step 4: Analysis of various options

The next step facing the working group committee is to analyse the various options in contracting out a service. These options are influenced by the ability of a particular market in a country to contract out a particular service.

According to the Commonwealth Secretariat (1995, p.59) they concluded that two main factors affected the success of contracting out: ***the nature of the market and the overall market conditions***. It was argued that the more competitive the market into which services would be contracted out and the better the overall macro environment and capacity to regulate, the greater the likelihood of success (Commonwealth Secretariat, pp.51-52). The argument is presented graphically below in Table 4.2.

Table 4.2: Capacity to regulate and market structure

High capacity to regulate	<p style="text-align: center;">Competitive Market</p> <hr/> <p><u>Decision:</u></p> <ul style="list-style-type: none"> <input type="radio"/> Privatised / Contracting out 	<p style="text-align: center;">Non-Competitive market</p> <hr/> <p><u>Decision</u></p> <ul style="list-style-type: none"> <input type="radio"/> Develop regulatory framework <input type="radio"/> Privatised / Contracting out
Low capacity to regulate	<p><u>Decision</u></p> <ul style="list-style-type: none"> <input type="radio"/> Privatised / Contract out but give attention to competitive policy 	<p><u>Decision</u></p> <ul style="list-style-type: none"> <input type="radio"/> Carefully access types of Privatisation management <input type="radio"/> Develop appropriate regulatory framework

Source: Commonwealth Secretariat 1995

The feasibility of contracting out will further be influenced by the suitability of the service activity and by the desire to obtain cost efficiency gains. The following factors will also influence the feasibility of contracting out.

Service standards : a key requirement is the determining of service standards or expertise and the ability of a contractor to meet these standards.

Legal requirements : the contracting out of a service should not impose or increase any undue risk or liability for the Local Authority.

Financial details : any proposed contracting out should be fully investigated based on existing and future cost whilst ensuring that the same service before and after is evaluated.

Technical skills : the technical skills of a contractor should be evaluated to ensure that they meet the minimum requirements.

Contract management : any successful contracting out is subject to the ability to manage the contract. The rule applies that more essential services are normally monitored more closely than non-essential services.

Step 5: Decision to contract out or not

When the above-mentioned factors have been evaluated by the working group they should have sufficient pertinent information to consider if a service should be contracted out or not. At this stage the Local Authority is ready to ask for bids or to place the service out on tender.

Before the final decision is however taken by the Local Government, the following factors normally also play a role, for instance political considerations, personnel considerations and service specifications. If the answer to all these factors are positive, a service is normally ready to be contracted out and the implementation phase will follow.

Discussions with staff and unions will normally commence at this stage. It will be of critical importance to consider and include the staff's view in the decision making process from this point onwards.

The process could be influenced by the views of staff and political decisions. If the outcome is, however, positive, specifications can be developed for the service to be contracted out.

Step 6: Determining the Contract price

Contracts should be rewarded on the basis of receiving bids from prospective contractors. This could also include a bid received from the management/employees of a particular service.

Where services are not readily available in the private sector a buy-out option by the staff will be a politically attractive alternative in the contracting out process. This option is, however, subject to the management/staff obtaining the necessary funding to purchase the assets.

Having completed a full analysis of the cost of providing the service prior to contracting out by the Local Authority they will be in a position to evaluate the different bids and to determine the contract price.

The price of the contract will have to be estimated over a specified period of time. Such a price must be adjusted to take into account the particular characteristics of the service being sought.

Two additional costs must be allocated to the contract, the cost of monitoring and the cost of the Local Authority's overheads associated with the monitoring function.

The contract price to deliver the predetermined service will be calculated as follows:

A detailed analysis should be done to determine the existing cost of providing the service in the Local Authority. This should be followed by calculating the cost of providing the service by a private sector company. The difference in cost should be given back to the Local Authority as direct savings. When the contract is signed for the delivering of the service, the cost of providing the service must reflect the savings passed back to the Local Authority in the form of a lower contract price.

The question is automatically asked as to why the private sector can operate the service cheaper than the public sector. The reasons why there are cost advantages in contracting out have been discussed in the earlier chapters of this report. There are, however, two specific issues which will play a major role in cost savings.

Pensions and medical aid benefits in the Government sector in this country are unique. The employer's contributions are particularly high. In many cases, twice as high as would typically be found in the private sector. It is possible, in South Africa, to find similar benefits in a private sector fund with considerable reduced employer contribution rates. It is savings like these that can be passed back to the Local Authority in terms of a lower contract price.

Step 7: Drawing up the contract

The contract document is central to any contracting out project and for this reason, the contract must be clear and devoid of any superfluous views and requirements and where possible, wordiness must be avoided. The format of the contract should be simple and follow a logical form.

The contract needs to clearly specify the service standards and also the method of monitoring. Penalties for non-performance are normally an incentive to ensure good performance. Full details of what should be included in the contract is described in 2.12.1 above.

Step 8: Implementation

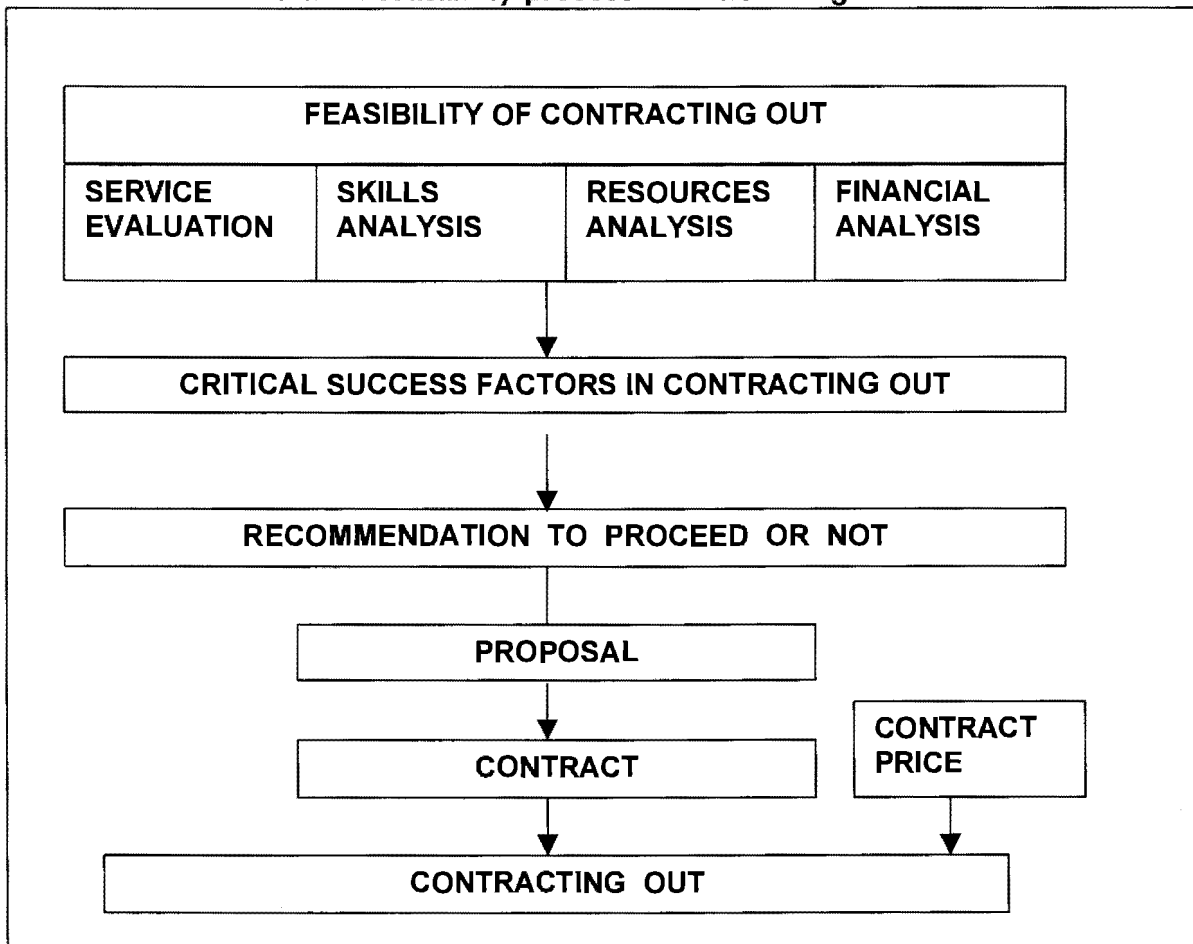
On receipt of all the above-mentioned information the Local Authority should be in a position to make a decision based on the merits of the facts in front of them.

The decision to contract out should include the economic cost benefit evaluation taking into account all the direct costs as well as indirect costs and social costs in order to properly ascertain whether there is any advantage in contracting out as to compared to performing the work in-house. Should this decision be positive the successful contractor should be requested to implement.

4.3 Feasibility of Contracting Out

As part of the assessment of viability to contract out a service, step 3 of the model, a detailed feasibility study is undertaken. The detailed process is outlined in Table 4.3 and will be discussed in detail below.

Table 4.3: Detailed feasibility process of contracting out



The first step in any feasibility study is to include the appointed working group, as discussed above. The feasibility study will include a service evaluation, skills analysis, resource analysis, financial analysis, the determination of critical success factors for contracting out that particular service and the projection of the cost for the new company which is to conduct the service. This should lead to the decision to proceed or not (Step 5 in the model).

4.3.1 Service evaluation

A detailed analysis of the existing services provided in the department is necessary. It is often found that departments are providing services without the knowledge of management or that there is a duplication of services to be found within the Local Authority.

This analysis is important in order to establish the nature of the service provided by the departments and to ensure that the prospective contractor will provide at least effective and similar service to what the Local Authority department did. It can also serve as a checklist for officials and politicians to determine if they want to retain certain services previously performed by this department. An example of a service evaluation outline is included in Table 4.4.

Table 4.4: Outline of a service evaluation

SERVICE EVALUATION: Sandton Town Council CLEANSING DEPARTMENT
<p>In a service evaluation, by First National Bank of Southern Africa Ltd; on the specialised services provided by the Sandton Cleansing Department the following eight services were identified:</p> <ul style="list-style-type: none"> ○ Domestic Refuse Removal ○ Bulk Business and Industrial ○ Special Businesses (e.g. restaurants, hotels etc) ○ Street Cleaning Services ○ Garden Refuse ○ Special Removal Services ○ Animal Carcasses ○ Septic Tank Services <p>In order to prepare a full cost analysis it was necessary to analyse each of the above mentioned services in detail in terms of equipment used, resources, service levels and cost.</p>

According to Marlin (1984, pp.18-19) there are seven factors which should be reviewed:

1. Definition of the service
2. The service size
3. Level of expected service
4. Extent of in-house capability
5. Existence of a viable private sector
6. Possibility of using non-profit organisations
7. Possible side effects of contracting out.

4.3.2 Skills analysis

The next step in the feasibility study is to do a full skills analysis. This will entail that all the skills necessary in the existing department to deliver the service be identified. In addition to this, it will be necessary to determine which additional skills will be necessary to deliver the service once contracted out.

The skills analysis is seen as critical in determining the cost of the contract and also to ensure the continuity of the service once contracted out. If a particular skill is not available at present the cost of acquiring this skill must be included in the budget for the new contractor. Non-completion of the skills analysis, based on personal experience, normally leads to unsuccessful contracting out.

4.3.3 Resources analysis

Like the skills analysis it is necessary to undertake a full resource analysis in the present service, as well as resources necessary in the contracted out service. The main reason why this aspect is regarded as important can best be illustrated by an example.

During a recent investigation into a cleansing service, First National Bank of Southern Africa Ltd; found the vehicles to be in a dilapidated state. These vehicles are to be sold to the private contractor and unless the contractor includes a vehicle replacement programme in his contract, the service will most definitely deteriorate in quality if the new contractor relies on the old vehicles. This factor could therefore influence the price of savings passed back to the Local Authority and the lowest quote could in this case, not be the most favourable for the Local Government.

The same investigation should be done for all other resources used in a department and other examples include vehicle repairs, computer back-up, human resources and sourcing of materials. It is often found that the resource investigation can lead to financial savings in other departments if the service is contracted out, for example municipal repair shops might work less overtime if the cleansing fleet is no longer serviced by them.

4.3.4 Financial analysis

To quantify the disparate elements that make up a service, some sophistication is required regarding various cost measures and models. These may range from number of personnel, their salaries and fringe benefits, the facilities owned by Local Authorities, the distance travelled by workers, incident rate, insurance cost, pension funds and medical aids. Depending on the nature of the service, other factors could be added. The result of this investigation will be a true reflection of the existing cost to provide the service.

Once this study is completed, a cost analysis as to what the cost would be if the service is contracted out, must be completed. All the known savings will result in direct upfront savings for the Local Authority. The cost analysis should include the following costs: fixed and variable cost, avoidable cost, direct and indirect costs, sunk cost, external costs, replacement costs, inflation adjusted cost, estimated costs and standard costs.

The cost analysis normally includes the:

- analysing of current, total Local Authority expenditure, including direct and indirect costs;
- normally it is advisable to do this for a five year period to enable one to identify any trend in cost allocation;
- drawing up a direct and indirect cost budget based on actuals for the past five years;
- determining a method of allocating these costs; and
- adding direct to indirect costs to determine the total cost of providing this service.

Direct cost are those associated with the main service objectives of a service. In other words, direct costs measure the cost of resources used in delivering a particular service. These costs normally include personnel, facilities, equipment and materials, training cost, replacement of assets and transport costs.

The next level of costs that need to be defined is social costs which could be defined as negative externalities - that is, uncompensated damage to the non-producers of a good or service that results from the actions of the producer of the good or service.

According to Wisniewski (1992, p.110) a classic example is air pollution from an unregulated industrial smoke stack which inflicts damage on others, yet the amount of damage on other is not counted as part of the cost of industrial production. Although these intangible costs are at best difficult to quantify they still should be included in the cost analysis. Failure to do so could be the potential downfall of the service to be contracted out.

The economic feasibility study should therefore include direct as well as indirect cost and social cost of the existing service. Once this model is completed it will be possible to determine where costs could be saved or to require tenders from the private sector. Meaningful comparisons are then possible.

In the case of an essential service this cost analysis could also assist in determining the viability of any tender document to ensure the potential service provider will be in a position to financially provide the required

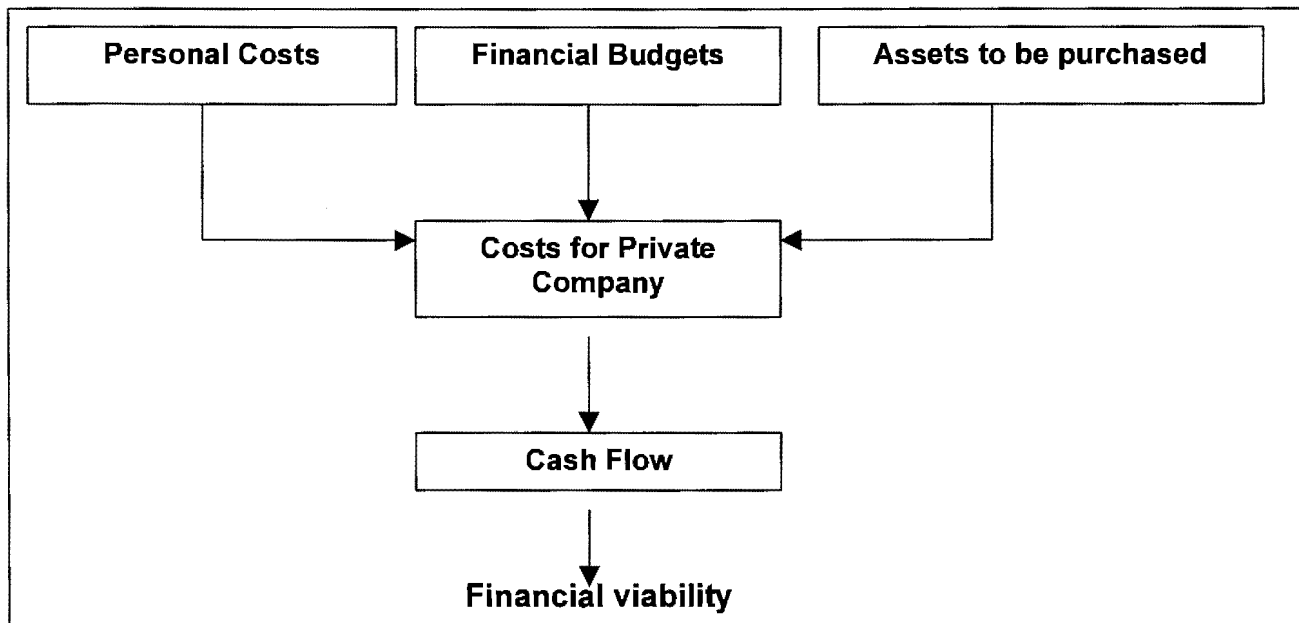
service. This should provide the necessary safeguard against exaggerated cost savings, or abuse which could ultimately result in the ratepayer being short-changed. Meaningful safeguards could therefore be developed from the cost analysis.

Another important aspect which the working group will be faced with, is the determination of the principles of valuation of the movable assets. This will be necessary if the contractor will be buying or renting any of the property from the Local Authority. Although the valuation method must be fair to all, it must also be borne in mind that some assets, if sold at its market value, might result in a contractor being uncompetitive and in such a case, it might be advisable to lease the asset to the contractor at a fee which will be fair and which will ensure the continuation of the service at an acceptable price.

4.3.4.1 Financial Viability Model

The feasibility study would result in the compiling of a financial model which can best be demonstrated in a diagram as stated in Table 4.5.

Table 4.5: Financial viability model



4.3.4.2 Personnel Costs

The staff of the service under investigation generally constitute the largest single item in the Local Authority department's budget. It is therefore vital that the personnel component of the department is investigated in depth if it is envisaged that the staff will form part of the contracted out service or as an additional cost to the Local Authority once contracted out. The model should capture all relevant data concerning each individual employed by the department.

The average age of employees and a length of service analysis can, for example, provide useful information regarding the strategic direction and management structure of the new Company. The total cost of all employees should also be investigated and then compared to the Local Authority budgets. This process identifies all costs related to the salaries and wages component of the department's budget.

The database of personnel information is also a useful tool in determining service levels, staff loyalty, training programmes and as mentioned, the future management structure of the new private sector operator.

4.3.4.3 Financial Budgets

The success or failure of any investigation rests on the ability of contracting out to deliver financial benefits to the Local Authority. The potential savings can only be determined once a complete understanding of the costs, related to the service is obtained.

The actual results of the department over a number of years and the forecasts for the following year are therefore captured and analysed.

Important aspects which are highlighted by the model are the year on year increases or decreases, the percentage each item makes up of the total expenditure and the trends over years for each expenditure item.

From this analysis various issues can be identified for further investigation, if so required.

4.3.4.4 Assets to be Purchased

Details of all assets to be purchased by the private sector operator or rented from the Local Authority are captured. Reports on the age of the assets, market value, cost and loans outstanding are analysed in order to determine replacement programmes, rental and purchase prices.

4.3.4.5 Cost for Private Company

All of the above modules produce information from which it is possible to calculate the budgets for the new private sector operator including operational expenditure and capital programmes. Savings which will accrue to the Local Authority could also be calculated.

4.3.4.6 Cash flow

The "contracting out budget" is used as the basis for the company's cash flow. The contracting out model calculates the private sector operator's new cash flow on a monthly basis and indicates what the interest burden of

various methods of financing will be. Taxation, VAT, staff bonuses, inflation and interest are all accounted for and pro-forma income statements and balance sheets are produced.

In order to determine the feasibility of the contracted out department various scenarios should be run on the cash flow model. The results produced under these scenarios are used to calculate the best method of financing the purchase of assets as well as the companies working capital requirements.

4.3.5 Critical success factors in contracting out

Based on personal experience and the investigations and experience of First National Bank of Southern Africa Ltd; there are a number of key critical success factors which will determine if a service can be contracted out in South Africa. These critical success factors are:

- a. All interested parties must be identified and be involved in the investigation.
- b. The Local Authority must retain the responsibility for delivering of the service.
- c. All parties must benefit when this service is contracted out.
- d. All existing employees must receive an offer of employment with retention of existing benefits.
- e. Service standards must be determined and quantified.
- f. The main source of income for delivering the service for the new Company must be the contract price received from the Local Authority.
- g. A detailed agreement must encompass all these points.

Non-compliance with any of the above-mentioned points could mean that there is a chance that the contracted out service will fail.

The contract document is central to any contracting out project and for this reason, the contract must be clear and devoid of any superfluous views and requirements and where possible, wordiness must be avoided. The format of the contract should be simple and follow a logical form.

4.4 DRAWING UP A STRATEGIC PLAN

Contracting out is defined as the transfer to the private sector of activities and functions which have traditionally rested with the Local Authority.

In order to ensure the long term viability of the private sector operator, especially when ownership includes the previous management being department, it is of critical importance to insist on a strategic plan being drawn up. This section provides details of such a strategic plan which includes lessons learned in practical contracting out and case studies.

The first step in establishing any new business should be to identify a suitable opportunity. This is done in the identification of the service to be contracted out.

Potential rewards and growth opportunities are often outstanding but entrepreneurs focus most attention on technical or developmental aspects of the products - and stop short of critically important business considerations in starting a new company. For this reason a suitable strategic plan should be drawn up which is an essential part of launching a successful enterprise.

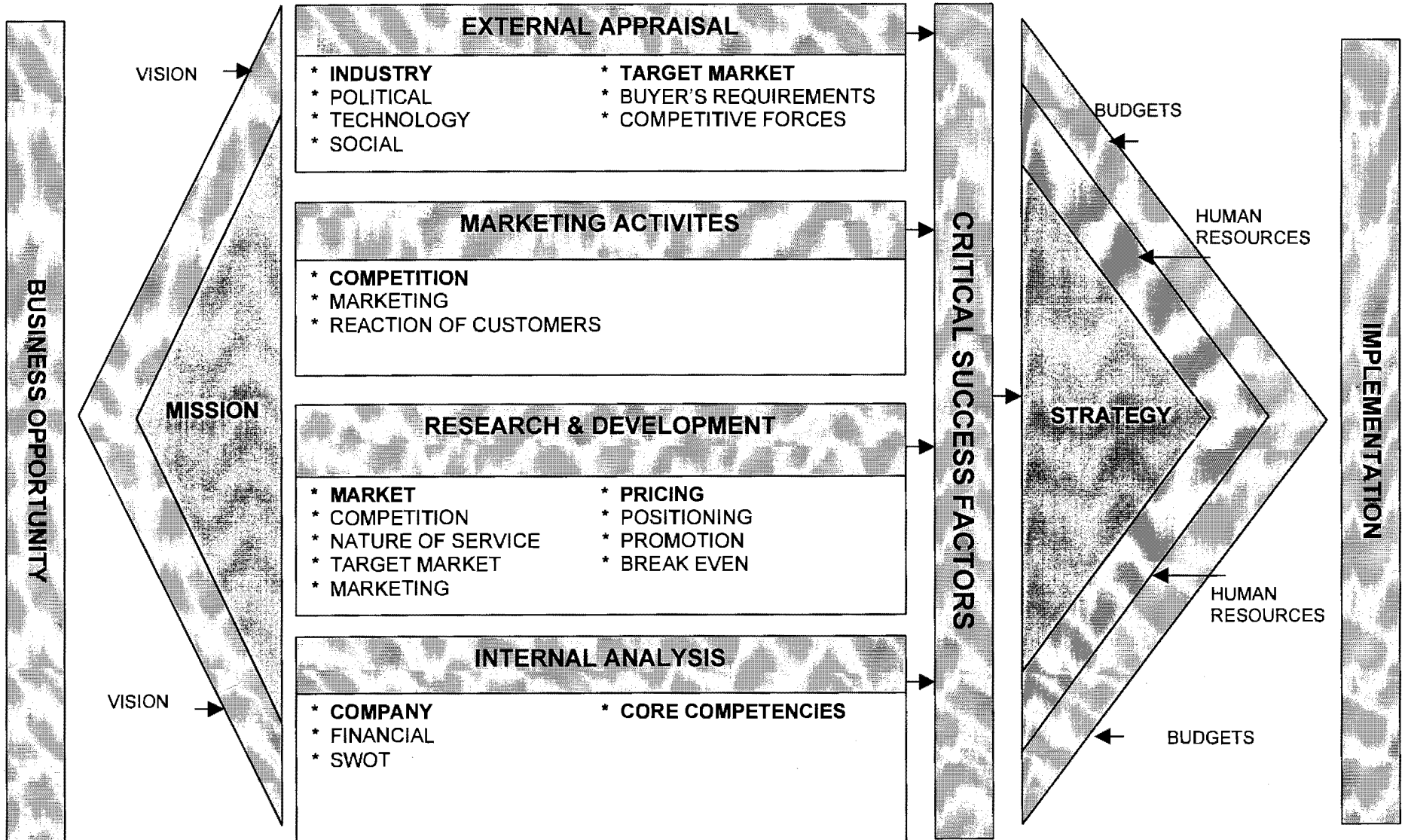
The aim with this strategic plan is the following:

- * To assist in determining the feasibility of pursuing the difficult steps necessary to start the new company.
- * To provide the necessary information needed to raise the necessary funds.
- * To provide a firm basis for developing a more detailed operating plan.
- * To improve internal feedback by translating the business proposal into numbers and vice versa.

4.4.1 Strategy formulation

The strategic planning framework, as set out in Table 4.6, was deduced from interviews and practical experience in contracting out projects as well as personal involvement in assignments. The framework is supported by success cases throughout the world.

Table 4.6: Strategic planning framework



4.4.2 Overview

4.4.2.1 Historical Information

It is important that historical information and especially that historical financial information be obtained. This should be used as basis for the financial viability study and also to determine trends in demand for service, replacement policy for equipment, maintenance and financial feasibility study which will form the basis to obtain the necessary funding.

4.4.2.2 Project

At present Local Government, in South Africa provides several types of services to ratepayers. The changing political order within South Africa is demanding a revisit of the cost to provide these services, or alternatively the standard of service provided.

Their aim is to find more cost effective ways of providing services or to provide the same service to all communities in the area without increasing the total cost of the service. This concept of out sourcing or contracting out is an ideal opportunity for an entrepreneur. In order to analyse this opportunity a new business plan could be written. In some situations, only part of the outline described below will be appropriate, in others the full outline could be used. In either case, however, the plan should always be tailored to the specific situation and objectives.

An effective plan should emphasise the strengths of the proposed business but it should also be the major medium to long term opportunity for shareholders of the business who, in most cases, take over an existing service from a Local Government in providing at least the same service. The service should, however be provided in a more effective way which could result into profits, instead of a break-even position, for the company. In addition existing infrastructure could be used to provide services to other users which could create additional financial benefits for the company and its shareholders.

4.4.2.3 Company description

The White Paper on Privatisation and Deregulation in the Republic of South Africa (1987) in its criteria for privatisation recognises the fact, that a service can be privatised. This means that the service, with the consent of the Local Authority, can be taken over.

This company, in terms of a contract entered into with the Local Authority, will provide the service whilst the Local Authority remains responsible for the provision of the service.

The actual service is therefore contracted out to an agent who could take the form of a company. Conceptually the company will render a service on behalf of the Local Authority for a set fee or retainer.

4.4.2.4 Principal products, markets and applications

In order to understand the business opportunity it is necessary to investigate in detail and to define the company's products, markets, applications and services.

In addition, other business opportunities using the same infrastructure should be investigated. This means that existing infrastructure could be used to provide an external service to other users, be it in the public or private sector. Better utilisation of existing infrastructure could lead to additional profit, but this possibility should be carefully investigated.

4.4.2.5 Distinguishing features

The cost of providing the nominated service to the Local Authority, in terms of a contract, should be pre-determined yearly in advance and if the company fails to implement any efficiency improvements, which is unlikely, it should break even.

The cost of running the company is therefore paid and it can now use the infrastructure, without influencing the level of service provided to the Local Authority, to provide services to other users. The cost structure of the company should be such that it is in a position to compete favourably with other companies. Although the company could have the infrastructure and human resources to provide additional services, it might be required to purchase additional movable assets. By providing additional services to other users the income received could also be used to subsidise the services provided to the Local Authority.

The main reason for this step is to ensure that the contract with the Local Authority is retained. This might be crucial to ensure that the company has the necessary infrastructure to compete with the private sector.

4.4.3 Future mission of the company

The Company should define its mission for the future. In other words define the business in terms of its market and products or services.

4.4.4 Vision Statement

Based on the mission of the Company a vision statement should be drawn up.

4.4.5 External Evaluation

4.4.5.1 Industry description

The industry in which a new company operates will need to be analysed in full. In most cases services provided to a Local Authority are specialised. To illustrate the point an industry description for the fire industry as follows is discussed as follows:

Case Study: Fire Industry

According to Barber (1991, p.41-44) the fire industry in South Africa started as early as six months after Van Riebeeck landed. It was October 1652 that the following notice or "plakkaart" was read out and exhibited: **"Whereas the guardhouse and other habitations are made of wood, roofed with reeds, being subject to fire, no one, whoever it may be shall not, night or day, bring fire or torch into the house or garden house, nor smoke or allow smoking"**.

Barber (1991, p.53) goes on to say that fire fighting was made the responsibility of the Burgher Senate from 1796 until its abolition in 1828. Finally in 1840 the Municipality of Cape Town was established and assumed the control and provision of fire fighting services. This was seen as the start of the fire industry in South Africa as we know it today.

In 1977 and 1978 the four provinces each promulgated a Fire Brigade Service Ordinance which stated that a Local Authority may establish and maintain a fire service. Although provision was made for the Administrator to instruct a Local Authority to establish and maintain a fire service, this power was never exercised.

The various ordinances were repealed in 1987 with the enactment of the Fire Brigade Services Act 99 of 1987.

One important clause included in the Act stated that a service, not under the control of a Local Authority, can apply to be declared a "designated service" for example a service with all the legal status of a municipal service and enjoying the same legal powers. Although this was perhaps intended to give authority to the numerous services attached to major industries, which protected their own plant, it means that a private service can operate a fire service with all the legal powers bestowed on public sector services. An example of a Fire industry analysis is included in Table 4.7.

4.4.5.2 Political

The success of any contracting out process will depend heavily on the Government's political will and commitment to the process and its ability to sustain this commitment during the implementation period.

This commitment or political will at National Government level must be supported at Local Government level. It is therefore important that the policy statements of Government and Local Government be examined in this regard.

The success of any contracting out process will be measured by objectives set at local level and should indicate specific aims and why the proposed method has been chosen as the most appropriate to meeting the local objectives.

Table 4.7: Example: Industry analysis summary

Industry description	Fire Industry Ambulance provision
Size	<p>Fire: At present most towns in South Africa (719) have a fire service.</p> <p>Ambulance: Gauteng - Municipalities act as agent for Province Free State - Municipalities act as agent for Province Natal/Cape - Provided by province itself</p>
Characteristics	Compares well with most countries in the world
Major customers	Local Authorities; Airports; Large businesses re Sasol; Petrol Companies and the Air Force
Trend in Industry Worldwide	To contract out services but to maintain responsibility
Growth opportunities	Towns in South Africa will need more fire and ambulance service to neglected areas. Existing services in those neglected areas are either poor or non-existing.

4.4.5.3 Social

The availability of a service to all ratepayers in a Local Authority is essential. The social impact of the level of service and the impact on residents needs to be researched in detail, as the Local Authority is contracting with the company for the rendering of services to the total community.

4.4.5.4 Technology

To provide any service to Local Government, the company will be dependent on technology and the necessary equipment to support this. The company will have to ensure that both the technology and equipment used for this service is correct and acceptable. The aspect of providing technology could further be a major opportunity for the new company, for example to become a provider of services to the private sector.

4.4.5.5 Target Market

Most services regained by Local Authorities are specialised, making target market identification reasonably easy. The same target market could be identified in the private sector e.g. Municipal Bus Service and private users of a bus service.

4.4.5.6 Buyers Requirements

In terms of discussions held with Local Authorities where contracting out was considered, the requirements for a contracted out service are as follows:

- Standard of service must be maintained and guaranteed.
- Must have cost advantage for Local Authority to contract out.
- Local Authority retain responsibility for providing the service.
- All staff must be taken over by the company.
- Company must ensure replacement of equipment during contract period.
- Company must ensure that training of staff will continue.

These requirements should be stipulated in a detailed contract which will also include methods of monitoring these requirements. The impact when a service is contracted out on the end user of the service, (the ratepayers), should be minimal. By contracting out the service most ratepayers should not even notice the difference. Experience at First National Bank of Southern Africa Ltd; confirmed the need to prove to the Local Authorities that the following is important: By contracting out this service we will not change what we do but how we do it."

4.4.5.7 Competitive forces

To conclude the external appraisal it is important to qualify the competing forces in the service. This appraisal will clarify the competitive strengths which in turn will assist in forming the strategies for the company.

4.4.6 Generic Marketing activities

4.4.6.1 Competition

By entering into a contract with the Local Authority to provide the service, the company should for the duration of the contract not have any competition on condition that it meets the terms and conditions of the contract.

On renewal of the contract the company will have to tender for the provision of the service against other providers of the service.

The company should however, be up against existing companies in providing any of the additional services as identified under other opportunities. This should assist the company in measuring itself against the market which will in turn ensure that the company stays on the forefront of development. This will also assist the company when it has to renew its contract with council.

4.4.6.2 Marketing Activities

With the Local Authority being its biggest customer and its main source of income, it is obvious that the company will have to ensure that the Council and its ratepayers are satisfied with its service throughout the duration of the contract.

To achieve this it is suggested that the company draws up a service charter, which will stipulate the services the company should provide to the community. These services should be outlined in the contract between the company and the council. By informing the ratepayers what they can expect from the company, it will ensure that the community does not have false perceptions or expectations about the service.

4.5.6.3 Selling Activities

The company should be in a unique position enabling it to identify potential additional customers. The company should identify clients in need of similar services and senior staff of the company should market these services to potential customers. The cost of providing additional services should be low as the infrastructure is already in place.

4.5.6.4 Reaction from specific prospective customers

It is important to establish the reaction from the following prospective customers well in advance to enable the company to plan accordingly.

- **Local Authority**
As long as the company can ensure the same level of service with substantial cost benefit they should support it.
- **Officials**
The potential reaction from officials in the Local Authority should be measured. For instance officials could fear job losses or political interference in the process of decision analysing. A detailed plan should be drawn up to liaise with the officials.
- **Labour Unions**
Jobs of existing staff should be guaranteed and it is normally important to ensure that the union does not loose members in the process of contracting out.
- **Ratepayers**
As long as the service is continued as is, no opposition should be received on condition that ratepayers are not required to pay more for the same service

4.4.7 Research and development - New Product(s)

One of the main reasons why contracting out should be implemented, is the ability of the new company to use its existing infrastructure to expand into other areas that would not have been available to the department before. This will have the direct result of generating additional revenue for the company.

The normal development cycle of product development will therefore not be necessary and new product development should be in line with the core business of the new company.

4.4.7.1 Target Market

The target market should be identified in the business' immediate operating environment.

4.4.7.2 Pricing

The price structure should in most cases be determined by the contract between the company and the Local Authority. Where a company intends using its infrastructure to provide services to other customers, they will need to develop their own pricing structure and policy.

4.4.7.3 Positioning

The service should be positioned, in terms of quality service in particular to ensure that the service levels are maintained and to ensure that the company is well placed to compete the private sector.

4.4.7.4 Promotion and Marketing

The resources allocated to promotion and marketing of its products/services must be appropriately investigated to gain maximum benefits.

4.4.7.5 Break even analysis

A detailed break even analysis should be done and an outline of such an analysis can be found in Table 4.8.

4.4.7.6 Viability study

This viability study will indicate if a service could be provided at a profitable basis. What is important is to confirm the principle that the service based on existing infrastructure is viable, as set out in the projected income statement Table 4.9.

4.4.8 Internal evaluation

4.4.8.1 Company analysis: Inbound Logistics

The company's inbound analysis should include the following:

- a) Age analysis of staff to be taken over from the Local Authority.
- b) A retirement profile of the same staff.
- c) Existing salaries of these staff.
- d) Movable asset analysis in terms of value, age and possible replacement requirements.
- e) Fixed assets analysis in terms of cost, location and possible rent price.

In this analysis it is important to quantify the full effect of the above-mentioned on the Local Authority. This includes direct and indirect costs.

4.5.8.2 Operations

A detailed analysis in terms of a full statistical analysis should be completed in terms of actual service provided before contracting out. This information will not only be used in the cost analysis, but it is also important in terms of a data base for comparison for future years.

Table 4.8: Outline of break even analysis

<u>BREAK EVEN ANALYSIS</u>	12 Months	12 Months Adjusted
<u>Average Fixed Cost per Month</u>		
Finance Costs per annum (Of Total Investment)		
- Annual Depreciation		
- Bad Debts Provision		
- Rent of Buildings		
- Marketing Costs		
Average per annum		
Average per month		
<u>Average Variable Costs</u>		
- Labour		
- Operating Costs		
Average Income		
Average Marginal Income		
<u>Average Break-even</u>		
- Average Fixed Costs per Month		
- Average Marginal Income		
Break even		

4.4.8.3 Financial background

A detailed investigation into the existing Local Authority's financial budget should be completed. This analysis should normally include financial data for five years. This data could be used to complete a progressive regression analysis to determine the service future budget (without proposed savings at this point in time). This exercise should be completed twice, once without the proposed savings based on the financial budget of the Local Authority and the second time with the proposed savings. By completing this exercise twice the proposed savings for the Local Authority for the proposed contract period can be determined.

4.4.8.4 SWOT Analysis

In order to identify the opportunities for growth, diversification and the opportunities for cutting cost it is necessary to do a Swot analysis as indicated in Table 4.10.

Table 4.10: SWOT analysis matrix

Potential Internal Strengths	Potential Internal Weaknesses
Potential External Opportunities	Potential External Threats

Source : Strickland (1992, p.88)

4.4.8.5 Core Competencies

On completion of the Swot analysis the core competencies of this company should be identified. These competencies are something that the company does especially well in comparison to rival companies. According to Strickland (1992, p.88) a core competence is a basis for competitive advantage because it represents specialised expertise that rivals do not have and cannot readily match.

4.4.8.6 Critical Success Factors

Having identified the core companies of the company it is now important to identify the critical success factors which should be important not only for the survival of this company but also to enhance its ability to diversify.

The typical critical success factors when a service is contracted out are as follows:

- Determining of contract price and method of increasing it on an annual basis.
- Standards of service to be quantified in a contract.
- Ability to diversify. Can it use the same core competencies to take on additional work? The company should be in a position to source additional contracts and in doing so should remove the dependence on the main contract.
- Ability to save cost (internal). Many internal opportunities exists in which staff can be involved by implementing an incentive scheme.
- Ability to raise the necessary finance based on the projected revenue stream.
- Financial expertise.

4.4.9 Competitive positioning of the company

In terms of the traditional services, which will now be provided on contract to the Local Authority, the company will not have any competition on condition that it operates within the terms and conditions of the contract.

The company must therefore use its best endeavour, to place the company in such a position, that the Local Authority has no option but to renew its contract for a further period. The Local Authority must therefore never be in a position to provide the service at a lower cost compared to the private company.

The company should have a competitive cost advantage in utilising its existing infrastructure to provide alternative services. The critical part, however, will be to find marketable alternative services. The service standard of alternative services could be higher than most opposition companies due to the cost advantage that could exist in the company.

4.4.10 Typical Strategies of a service contracted out

The typical strategies of a company in this situation will be as follows:

- Maintaining existing contract.
- Renewing of existing contract when due.
- Diversifications and expansion of services.
- Building business expertise.
- Human Resource development.

4.4.10.1 Maintaining existing contract

It is essential that the company provides the City at least the service as required in the contract between the Company and Council. The aim should be to provide a better service.

4.4.10.2 Renewing of existing contract when due

The company will be largely dependent on a single customer base and it is therefore essential that it develops strategies to ensure the renewal of the contract.

4.4.10.3 Diversifications and expansion of services

To reduce the dependence on the above-mentioned single customer base, it is also essential that other markets are developed through the provision of services.

4.4.10.4 Building business expertise

It is imperative that a comprehensive training programme is introduced to entrench business principles.

4.4.10.5 Human Resource Development

In order to use the existing staff in alternative services, a comprehensive Human Resources Development plan should be introduced to improve customer service and to work smarter, for example, introduce innovative cost saving methods and to identify additional opportunities. The Human Resource Development plan should also identify methods to improve management capacity and succession planning. This should assist in ensuring continuation of skills availability in the company. An affirmative action programme should form part of the Human Resource plan for the company.

4.4.11 Project risk

When a service is contracted out, the company should analyse the project risk. These risks are normally critical to ensure sustainability of the company. The following project risks are normally present when a service is contracted out:

- ◆ Non renewal of contract.
- ◆ Funding of capital requirement by a Bank.
- ◆ To manage operational cost within fixed contract price, it is therefore essential that contract price be determined correctly in year one.
- ◆ Ability to grow the business by introducing alternative services.
- ◆ Termination of direct financial support of the Local Authority after contracting out.

4.4.12 Management and ownership

In the early stages of commencing this business, the company will depend on the ability of the existing people to provide the technical service. The identifying of key managers and the assessment of their ability to perform is therefore essential.

4.4.12.1 Key Managers

A strong management team with the correct skills and personal chemistry should be identified and put together early in the implementation process.

In order to do this, the company should decide what kind of core management team they need to carry out its strategies. A skills analysis should also be completed and the right people should be identified to fill each slot.

In most contracting out situations First National Bank of Southern Africa Ltd; concluded that the technical skills were present, but that financial and Human Resources skills were absent. The cost to bring these skills in should be included in the financial feasibility study as an additional cost.

4.4.12.2 Commitment of staff

In order to attract and compensate key people and other staff, the following could be considered:

- Key staff could be offered small shareholding;
- Other staff could be offered share holding through an Employee Share holders Fund or other appropriate scheme;

- In addition the company should be in a position to implement an incentive scheme programme for staff in various ways.
- The company will normally be dependent on the following skills.
 - technical skills of key people
 - financial skills; and
 - Human resource management.

4.4.12.3 Directors

The following interest groups or people should normally be considered when the Board of Directors is constituted. In order to retain maximum benefit the chemistry of people appointed to the Board should be considered.

Table 4.11: Outline of a typical Board of Directors

Directors should be nominated by
Main Shareholder
Town Council
Employee shareholders trust
Ex Officio
Managing Director
Financial Manager

4.4.13 Human Resources

4.4.13.1 Staff numbers by category

In the event of existing staff being taken over an offer of employment, that will at least match their present conditions of employment and benefits should be given to all staff.

4.4.14 Funds required

4.4.14.1 Immediate requirements

The company will need funds to purchase the movable assets (and fixed assets if applicable) from the Local Authority. The amount required, as determined by valuing the assets and agreed to by the City Council should be carefully calculated. These amounts will form the basis of determining the

purchase price.

4.4.14.2 Future requirement

Detailed long term cash flows should be drawn up. These projected cash flows will be used to determine future facilities required from a bank.

The above-mentioned cash flows normally excludes the provision of other business opportunities, not included in the contract between the Local Authority and the Company, but the initial capital requirement, to purchase the assets, should be included in the cash flow analysis.

4.4.14.3 Use of funds

The cash flow as outlined above includes the following:

- Purchase of assets from City Council.
- Replacement programme for vehicles and equipment
- Contract price received from City Council to provide the required service.

4.4.14.4 Debt and equity capital

The ratio between debt and equity in the new company should be determined up front. In most cases the gearing will be high, up to 100%, but a target for reduction should be committed to up front.

4.5 CONCLUSION

The Contracting out model described in this chapter is based on successful experiences in contracting out of services of Local Authorities in South Africa.

In this chapter we explored the basic steps involved in assessing alternative ways to deliver services. In following the key principles set out in the model any Local Authority should be able to consider the viability of contracting out a service. A positive decision should further lead to a full feasibility study and the drawing up of a strategic plan to provide an integrated plan for the service provider. In the next chapter the results of this model will be examined.

CHAPTER 5

RESULTS OF THE APPLICATION OF THE MODEL

5.1 INTRODUCTION

The previous chapter dealt with the development of a model to assist Local Authorities in determining the viability of contracting out as an alternative way of providing services.

Proponents of contracting out locally and internationally have proven that there are cost benefits when this process is introduced. Although there are a number of successful cases to prove this point, the number of successful cases in South Africa are minimal.

Contracting out as a mechanism to improve services will only be accepted as an appropriate, successful method if some successes are achieved. The fact that the private sector is prepared to risk their own capital should create sufficient incentives for others to follow.

In order to support the views expressed above, it is important to provide a local view on successful contracting-out projects. In this chapter the application of the model will be examined in three case studies.

5.2 THE BENONI TOWN COUNCIL FIRE AND EMERGENCY SERVICES

During 1990, Mr Steven Barber, the chief fire officer of the Benoni Town Council's Fire and Emergency Service and First National Bank of Southern Africa Limited; put forward a proposal to the Benoni Town Council to contract out the services.

Mr Barber, a dynamic MBA graduate of the University of Witwatersrand, had a firm belief in the advantages of contracting out as well as the business opportunities which could arise therefrom and was the driving force behind the contracting out of the services.

The service was officially contracted out on 7 April 1992. The company which was incorporated, Benoni Fire and Emergency Services (Pty) Ltd; commenced operations on 27 September 1991, in terms of a contractual agreement with the Benoni Town Council. Benoni Fire and Emergency Services (Pty) Ltd; was the first privately operated company in South Africa rendering fire and emergency services on behalf of a Local Government.

The company entered into a five year contract with the Benoni Town Council to render fire and emergency services. The standards of service are regulated by the contract. Benoni Fire and Emergency Services (Pty) Ltd; purchased all the movable assets from Benoni Town Council (which generated a R2,4 million capital inflow for the Council) and entered into a rental agreement with the Council in terms of which the Council properties are rented from the council. Benoni Fire and Emergency Services (Pty) Ltd; took over the staff complement of the services division numbering 178 people.

A few people were accommodated elsewhere in Benoni Town Council, as they did not wish to accept an offer of employment from Benoni Fire and Emergency Services (Pty) Ltd. People were taken over at the same benefits, which they have enjoyed at Benoni Town Council. Accordingly there were no job losses.

The operational cost for Benoni Town Council to run the service amounted to R10,7 million immediately prior to contracting out. A conservative projection of operational savings, which was done by First National Bank of Southern Africa Ltd; reflected savings of around R16 million over the five year contract period. Although the Benoni Town Council saved R 16 million in the first five year contract period it did not prevent the Council driving a hard bargain with Benoni Fire and Emergency Services (Pty) Ltd; when the contract came up for renewal at the end of 1996. The Benoni Town Council negotiated a very good fee structure on the renewal of the contract and this proved that the local authority does not have to forfeit power and influence by contracting out.

Over the five year contract period Benoni Fire and Emergency Services (Pty) Ltd; has done very well. The company's success has spawned nine new companies in related fields. Their income streams flow into a new holding company called Fire and Emergency Services Holdings (Pty) Ltd.

As a result of the growth, the Fire and Emergency Service (Pty) Ltd; group has created more than 300 new posts. This included the training of new emergency service workers from disadvantaged communities.

Mr Barber has identified some of the benefits which flowed from the contracting out of Benoni Fire and Emergency Services (Pty) Ltd;

- Employees are represented on the Board of Directors;
- Employees acquired equity through an employee shareholders trust;
- People with little capital now have the benefit of an equity holding in a company and that has contributed to the economic empowerment of employees within BFES;
- Staff participate in incentive bonus schemes;
- Management and staff operate in a non-political environment;
- Quick decision making is evident;

- An exercise of entrepreneurial skills by management and staff;
- Growth of the business into allied fields;
- No job losses or redundancies and the creation of new job opportunities;
- An effective training programme;
- The introduction of an affirmative action programme;
- New tax-paying entities created

(ii) REFUSE REMOVAL - BILLY HATTING EXPERIENCE

Nothing is quite as demoralising for a community as a bad refuse removal service. Billy Hatting & Associates (Pty) Ltd; have used a new approach to this problem. They believe that clearing up the area is only part of the answer. Creating business ventures in the community to remove refuse offers a more lasting solution. The company was set up in 1992 by Billy Hattingh, a waste management specialist. Hattingh developed a very different approach involving the community themselves. This model was first implemented in KwaNdebele. It has now been used in townships all over South Africa, including Ivory Park and Orange Farm in Gauteng and Motherwell in Port Elizabeth. More than 70 entrepreneurs have been set up in the waste removal business and more than 800 new jobs have been created.

Each project will have its unique requirements, which have to be addressed. Certain conditions underpin each project, notably:

- Projects are community-based and require members of the community to render refuse removal services in the community;
- The project must have community support;
- The potential for entrepreneurship must be evident;
- Employment opportunities must be created;
- Skills training must be enhanced;
- Small businesses are created;
- Effective and reliable refuse removal in disadvantaged communities;
- A cheaper and more effective refuse removal service in disadvantaged communities compared to what the Local Government can render.

A project will usually have the following characteristics -

- The company conducts a study for a Local Authority on whether and how a community-based refuse removal service can be introduced.
- The company enters into a contract for five years with the Local Authority to ensure that refuse removal services will be rendered in specific disadvantaged communities, should the Local Authority wish to introduce the project. There are three parties to this contract being the Local Authority, the company and contractor (who is an entrepreneur from the disadvantaged community).

- The areas which will be serviced by the entrepreneur is divided into economical stands or household units. In each of the units the community will identify an entrepreneur who will be the contractor in terms of an agreement.
- The entrepreneur will be assisted by the company to start his own business through which refuse removal services will be conducted.

The entrepreneur is owner and operator of the business and will employ people from the disadvantaged community to conduct refuse removal services.

- The entrepreneur, in terms of the contract, will receive management and refuse removal training from the company.
- The entrepreneur will purchase a specially designed refuse removal vehicle, with the company to negotiate finance on the entrepreneur's behalf. The vehicle will be fully paid off during the contract period with the entrepreneur to enter into an equipment maintenance agreement with the company during the contract period.

The Local Authority pays a contract fee to the accounting firm who are appointed to manage the funds of the project. The accounting firm then pays entrepreneurs monthly salaries, while entrepreneurs pay their own workforce. The accounting firm also sees to the salary payments of personnel of the company. This arrangement ensures prudent financial management of the project. The accounting firm also manages the entrepreneur's funds and repayments including all repairs, maintenance costs and expenses. The accounting firm forwards monthly management accounts to the company, the Local Authority and the financial institution which financed the vehicles. Performance standards are regulated by the agreement.

The experience so far suggests that community-based refuse removal programmes have increased the willingness of residents to pay their service charges. In Thokoza, for instance, there have been other benefits as well. For example, the entrepreneurs have cleared illegal dumping sites and have been instrumental in assisting communities to develop parks.

5.4 SPRINGS TOWN COUNCIL BUS SERVICE

Running the town's bus service was draining the Springs Town Council of vital funds. Then a bold decision was taken in 1993 to open bus transportation to private sector control. As a result Springs Bus Services cut losses dramatically. The gradual restructuring of the service has given the town a sustainable and affordable system of transport.

When the Springs Town Council called for tenders to take over the running of the town's bus network, Springs Bus Service put in a successful bid. They

bought the Council's entire fleet in a deal which was financed by the Springs Town Council itself. The Company took over the town's bus transportation in April 1993. They received a five year contract with Springs Town Council, which set out agreed service standards and financial control.

During the investigation to determine the viability of the service the following was found. The bus fleet operated for the benefit of residents and schools within the Springs Municipal borders. Buses transported passengers on scheduled routes, several of which were hugely uneconomical. Special bus trips and free services were also rendered for pensioners and residents. Total income generated by the bus service could not even cover the salaries and wages bill and equated to only 31% of total expenditure. In terms of local by-laws, Springs Town Council could not use the buses outside the municipal boundaries to earn much needed income from transportation contracts. To make matters worse, the old Transvaal Education Department also stopped paying a subsidy to operate a bus fleet for the benefit of schools. The bus service was accordingly a huge financial drain on Springs Town Council substantially depleting finances. At the time of contracting out, eight full time employees, 27 part-time drivers, together with another eight posts, made up the personnel component of the bus service.

Springs Town Council decided to contract out the services in order to:

- reduce the large operational deficit;
- rationalise and discontinue unprofitable routes which were hardly used by residents;
- move capital replacement costs of the bus fleet for the account of a private contractor; and
- guarantee a bus service for schools, which consideration was of extreme importance to Springs Town Council (70% of bus passengers are school children).

In its first year of operation, Springs Bus Service reduced the operating loss from R2,4 m to around R 680 000. Overall the Springs Town Council is expected to save R21m from contracting out this service. The Council is no longer burdened with the ongoing capital expenditure on busses and earns additional revenue from leasing out its bus terminus, depot and offices to Springs Bus Service.

Springs Bus Service has assisted the local community by donating two double decker buses for the disadvantaged community to use as classrooms for a nursery. Springs Bus Service further plays a role in the community by transporting people to and from funerals for a fee. During the November 1995 Local Government elections buses were made available to transport people, from all communities, free to voting stations. There is also a free bus service which is rendered for old age homes once a week. Springs Bus Services also played a role in alleviating the current plight of the unemployed

by creating a total of 29 permanent posts as well as the employment of 20 temporary drivers since contracting out. Four new buses have been purchased while some of the older buses were overhauled. Ticket prices have increased at the inflation rate during the time in which the contract has been in operation. Prices are none the less still slightly below current market rates.

During an interview with the Springs Town Council, conducted by First National Bank of Southern Africa Ltd; during October 1995 it was clear that the Springs Town Council is very satisfied with the quality of service rendered by Springs Bus Service.

5.5 CONCLUSION

In the case studies cited the proposed, contracting out model, has resulted in financial savings and enhanced efficiency by relying on certain fundamental principles. These include:

- Cost-effectiveness and service efficiency
- Transparency
- Continued Local Government responsibility
- A proper contractual relationship and monitoring process
- A good working relationship between the Local Authority and the service delivery agent

The contracting out can reduce existing service delivery costs or can extend services to new communities.

A transparent process creates a better understanding of the benefits of contracting out for all. All key role players - (government officials, council members, employees or their union representatives, the private sector and the community) should be drawn into the process.

It is also important to create participation which creates legitimacy and support for the project. An inclusive, participatory approach can assist in dealing with people's concerns. Interested parties should drive the process from the beginning and will ultimately determine the success or failure of the service contract.

The Local Authority always retains its legislative responsibility to deliver services to the community. This responsibility remains, even if a delivery agent other than itself is contracted to delivery the service.

A Local Authority must make sure that services are effectively monitored. It can appoint a contract manager, departmental head, or a field manager to monitor how effective a service is being delivered. Regular contact with the delivery agent is very important.

A good working relationship between the Local Authority and the service delivery agent is important to ensure that everybody understands the requirements and operational difficulties involved. Mutual co-operation will enhance the effectiveness and quality of services given to the community.

It is important to remember that every resident of a local community has a right to services whether they are delivered by the Local Authority or any other delivery agent. The ability of communities to pay for the service will determine the standard of the service which must be regulated. The standard of service must be regulated contractually, so that the agreed level of service will be maintained. Non-payment for services could lead to the downfall of not only the service provider, but the Local Authority itself.

In this chapter the case studies have shown how contracting out actually works in practice. The conclusions and recommendations are described in chapter 6.

CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 INTRODUCTION

A key challenge facing Local Authorities in South Africa is to find ways to improve and extend the delivery of services to their constituents. At the same time the huge financial constraints on Local Government in South Africa places Local Authorities at a clear choice, reduce services or find alternative, more cost effective ways to maintain and improve services. This study identifies one way to improve and extend the delivery of services to their constituents with potential financial benefits.

6.2 CONCLUSION AND RECOMMENDATIONS

The record of successful contracting out services on a large scale by Local Authorities in South Africa is poor. The main reasons for this poor performance are twofold, a lack of political will to contract out services and the absence of recognising the financial benefits that contracting out could have on a Local Authorities budget.

The process of contracting out is further crippled by the dispute between Government and Unions regarding the Government's suggestions regarding the restructuring of State assets. In the past the Government has also played a passive role in taking a firm position on the issue of contracting out notwithstanding all the papers written on this subject.

The demand for effective service delivery in South Africa has grown enormously. Local Authorities are stretched to such limits that it is becoming increasingly difficult to provide services at existing or acceptable standards. In response to these challenges many Local Authorities have begun to explore alternative ways to deliver service. There is ample evidence of a global trend for Local Authorities to use contracting out as a way to improve service delivery to their constituents.

Internationally it is acknowledged that the private sector is capable of delivering a more effective and efficient service in many areas of Local Government responsibility. Local Authorities should take advantage of private sector resources to ensure that public services like refuse collection and street cleaning are provided at a high level and at the lowest possible cost. Savings generated can then be used to build and operate new infrastructures in a cost-effective way.

Contracting out of services could achieve the following results:

- Generate annual operational savings of anything between 10% and 20% of Local Authorities' expenditure budget.
- Move future capital expenditure on moveable assets from the Local Authorities to the private sector.
- Create lease payments by the private sector for the rental of Local Authorities buildings
- Create a new tax-paying entity, so broadening the South African tax base.
- Generate an immediate cash injection, should the contracted company purchase assets from the Local Authority.

Local Government has a critical role to play in local economic development and ensuring sustained service delivery. When services are contracted out it should contribute to the long-term growth and employment opportunities within a local community. Viable small, medium and micro enterprises could be established which will render services contractually on behalf of Local Government.

Contracting out of services could also assist Local Authorities to take RDP initiatives to the community. RDP programmes and projects could in turn facilitate local economic growth and job creation and secure a capital injection to uplift disadvantaged communities. Such initiatives could create affordable and wider ownership in the economy.

Contracting out of the delivery of services presents a viable solution to many challenges facing Local Government in South Africa today. Contracting out of services could extend services in a cost-effective and efficient way to communities who in the past were denied them, while ensuring that existing service standards are maintained. Local Government could also benefit from the financial saving generated.

Local Authorities need to explore these new ways of delivering services, as one possible solution to creating an effective and clearly efficient service delivery system in South Africa.

The support of labour will enhance the acceptance of contracting out as an alternative way to deliver services. Government should remove some of the bottlenecks and draw up a contracting-out master plan which should be visibly supported at the highest level.

The master plan should reiterate that the Central, Provincial and Local Government are committed to this process and it should set clear, reasonable guidelines for this process to be managed. Commitment and guidelines towards this should form the basis for Local Authorities in South Africa to enter into partnerships with the private sector, to ensure delivery of services to all people.

The ideological and socio-economic issues that underpin the restructuring of State assets and also the contracting out of Local Government services, centres around the acceptance or not that a government can be responsible to provide a service but that a third party could provide that service on its behalf and that this should not necessarily lead to a reduction of jobs.

It is further recommended that a proper model, as developed in this study, be followed to contract out services. This model is currently being used by First National Bank of Southern Africa Ltd; as its official contracting out model.

The critical elements for this process to proceed can be found in the political will to contract out services, acceptance from Labour and the current financial pressure on Local Authorities. There is no reason for anybody in Government, Labour or the Private Sector to disagree on the benefits of contracting out.

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