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# PPP: The Right Marriage between Local Government and the Private Sector in Malaysia?

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***Abstract***: Public-Private Partnership has been employed in some local governments in Malaysia for some time in real estate development making local authorities a key player in the economic development of cities. However, little research exists on both the implementation of such projects and the evaluation of the governance procedures. This paper seeks to fill this gap by examining the working arrangement between selected local authorities and developers in striking a win-win situation. Towards this end, the paper examines the working arrangements between two local authorities and developers in Batu Pahat and Kuantan, as well as the subsequent post-project developments. The two cases in Kuantan exemplify successful partnerships that still exist while the third in Batu Pahat illustrates a failed partnership.

***Keywords***: local government, public-private partnership, privatization

***JEL classifications***: H77, O21, R11, R58

## 1. Introduction

Public-private partnership (PPP) has existed in Malaysia, at least since the mid-1980s under joint-venture arrangements between local government and developers. PPP is often confused with privatization but both terms are quite clearly distinguishable in Malaysia. PPP is seen as a derivative of privatization (Pongsiri, 2002: 488), a concept that emerged under the administration of Mahathir Mohamad who emulated the initiative of Margaret Thatcher in the United Kingdom. Accordingly, the Malaysia Incorporated Policy was launched on 25 February 1983 followed by the Privatization Policy on 19 March 1983. The latter is a tool used to implement the former. Today, the term privatization has eroded as it is slowly being replaced by the term private financing initiative.

In the past, PPP in Malaysia was subjected to a traditional view and perceived to be a derivative of the privatization policy but of late, it denotes private sector involvement in public infrastructure development. However, the

Privatization Masterplan issued by the Prime Minister's Department has failed to be an important guide for the implementation of the policy at the local government level. This is made worse as local government forms the third tier in the three-tier government structure in Malaysia, and local governments are subject to scrutiny and subordination by state governments, which form the second tier. The Economic Planning Unit (1991) appears to be a useful guide for federal and state level large projects and is less friendly to local government initiatives. The projects at local government level are usually minute as compared to those undertaken by the federal and state governments.

In addition, there is a paucity of literature, at least in Malaysia, that evaluates the outcomes of the exercise after a few years of implementation. Such being the case, this study contributes to much needed literature in the field. However, a preliminary study was documented for the Kuantan experience under the auspices of the Konrad Adenauer Foundation (Konrad Adenauer Foundation, 2000) as activities around ASEAN and East Asian countries.

This paper focuses on PPP with special reference to three examples from two local authorities in Peninsular Malaysia. The paper perceives the PPP exercise to be analogous to a marriage between local authorities and their private partners, and intends to demonstrate that the marriage can be successful given good leadership who are committed and personally involved to take the long-term initiative through. As such, the writer intentionally researched on examples of PPP successes and failures in a bid to make reasonable comparisons and obtain valuable lessons.

The paper begins with an examination of the literature surrounding the concept of PPP, and the confusion it faces with the term privatization. This is followed by a description of the methodology used in the study, and the experiences of the Kuantan and Batu Pahat Municipal Councils in implementing PPP. The paper concludes with a discussion on the experiences of both councils, and the lessons learnt.

## 2. Review of Related Literature

Governments are inevitably faced with the problem of a rise in the demand for better services and to provide these with the limited revenue resources available (Kolderie, 1984). Possible options to obtain revenues are to raise taxes and reduce expenditure; however, the former will receive serious objections from the people. Consequently, there has been a push to privatize services due to fiscal difficulty in sustaining services, and the pressure by donor agencies as a result of the slow pace of privatization and commercialization in developing countries (Batley, 1996). But contrary to the fear of civil servants, the role of public agencies does not cease to exist after privatization; rather, there is a change in role and ownership (Batley, 1996; Sundquist, 1984).

Although privatization was initiated under Thatcher, PPP has been used quite freely to imply the involvement of the private sector in its bid to cooperate with the government sector towards mutual concerns. The key concept then was that PPP involves a win-win situation for all parties in the collaboration. Partnership implies the agreement to work together to perform some tasks, taking the view that there may be hiccups which can be ironed out. Moreover, it emphasizes the need for good principal-agent relationship (Davis, 2005). However, there is confusion in the application of both terms, namely, privatization and PPP, and the literature in the field is clearly indicative of this confusion (Mitchell-Weaver and Manning, 1991; Jamali, 2004). In both terminologies, and in most cases, the asset is returned to the government at the end of a concession period. Broadly, Sanjeev (2008) defines PPP as "an agreement between the public and private sector to work together, allocating resources, risks and rewards between the partners" and views risk-sharing to be a key attribute of PPP. PPP also synergizes the outcomes of exploring untapped potentials in various areas, such as investment, that public agencies are unable to perform.

In the United Kingdom, PPP is seen as a partnership to develop public infrastructure with a private entrepreneur financing the project. In line with Engel, Fischer and Galetovic (2008), this means that the concessionaire will manage and control the assets in exchange for user fees to compensate for all its costs. The asset is to revert completely to the government once the concession period ends (Grimsey and Lewis, 2002). This provides the space to argue that PPP is similar to privatization, but the traditional thinking is that PPP is a subset of privatization. Interestingly, the national treasury of South Africa (www.ppp.gov.za) defines PPP in terms of what it is not, that is, not as outsourcing of functions where the institution retains substantial financial, technical and operational risk; not a private donation for public good; not a commercialization by creating a state enterprise; and does not require states to borrow. This definition may eliminate some of the items currently being described as PPP by the literature.

Linder (1999: 36) distinguishes both PPP and privatization in that the former entails cooperation and joint venture. Although Engel, Fischer and Galetovic (2008) argue that PPP cannot be justified just because they free public funds, they suggest that PPP are closer to public provision than to privatization. They claim that PPP "bundles" investment and service provision in a single long-term contract. However, PPP may entail shifts in accountability arrangements and the need for reporting, and therefore a well-defined regulatory framework is essential (Pongsiri, 2002). However, Pongsiri also cautioned the possibility of over-regulation and warned that contractual safeguards would restrain economic growth and limit the private sector's ability to remain competitive.

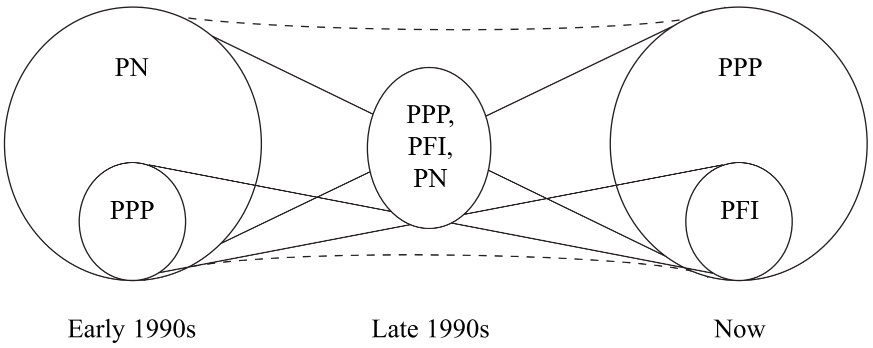
Savas (2000) keeps to the conventional belief by viewing PPP as a form of privatization and contracting-out where the private sector and the government develop a capital-intensive infrastructure using mostly private financing, and subsequently operate under concession by the private partner for a stipulated period of time. Indeed, PPP has been seen to develop and demonstrate new and effective ways of addressing public problems (Kolderie, 1984). Furthermore, if PPP is successful, it would be possible to attract other business entities to attempt similar ventures. However, Wettenhall (2003: 82-83) criticizes that partnership has been loosely connected with privatization, outsourcing, contracting out, commercialization and anything to do with public-private mix. He examined the literature based on the view that PPP is an extension from public enterprise into privatization, and posted the view that the term PPP is often mixed-up with variants of privatization.

The move to formalize privatization is receding in a number of developed countries. For instance, in the United Kingdom, the term private financing initiative (PFI) has rather been used in place of privatization since 1992 (Broadbent and Laughlin, 2003). PFI takes the form of design-build-finance-operate which is quite similar to the definition of PPP. In fact, Broadbent and Laughlin (2003) and Hodge and Greve (2007) think that PFI and PPP are synonymous. However, Allen (2001) states that PFI is distinguishable from privatization as the public sector still retains a major stake in the projects; which is not feasible under privatization. Departing from Allen (2001), Glaister (1999) accepts PPP as a part of PFI. He terms both of them as being just two forms of best practices, and examines the abuses and uses of private financing and PPP in the transportation sector in London. He claims that PPP has evolved from PFI as a form of procuring services of the private sector providers and lately has incarnated into what is called PPP under the Labour government. This is quite contrary to the earlier discussion that PFI comes after PPP.

The foregoing discussion can be summarized and illustrated as in Figure 1 which shows the evolution of the perception of PPP from the traditional (left) to the modern (far right), where the notion of privatization appears to be subsumed under the concepts of both PPP and PFI. In the middle, the diagram shows the multiplicity of all the terms, and the resultant confusion.

Grimsey and Lewis (2004) elaborate on the various issues that may emerge from contract management in a PPP initiative. These include service delivery problems and availability, and a string of risks involving the public: assets, operations, sponsors, financial and default risks. They also highlight the fact that many do not take into account the long term risks that the public sector will have to take charge of when the asset is returned to the government (and it is during this time that the assets require huge maintenance costs and more attention). Hodge and Coghill (2007) compared three infrastructure

Figure 1: The Locus of PPP




Note: PN – Privatization; PPP – Public private partnership; PFI – Private financing initiative.
Source: Author.

development projects involving privatization, one of which is PPP, in Victoria, Australia. They conclude that there would be lower political accountability in contrast with higher managerial and market accountability. Privatization entails transferring of risks, especially financial, to the private sector. They also highlight that accountability to the people in providing public infrastructure erodes when it becomes private, and stress that there is a serious need to maximize transparency and accessibility to information. One of the strongest points of PPP is the existence of a strong organizational and financial relationship between the public and private sector operators, especially involving joint-ventures, joint stock companies and joint development projects (Hodge and Greve, 2007).

Li *et al*. (2005) list the types of PPP that befits UK as assets sales, wider market, sales of business, partnership companies, PFI, joint ventures, partnership investments, and policy partnership. This list is comprehensive and applies also to Malaysia.

### *2.1 Partnership at Local Government Level*

Partnership programmes are evident in urban renewal initiatives involving local governments and entrepreneurs (see Batley, 1996). Batley's (1996) study find that services are more effective after privatization. Wettenhall (2003) cites the Dutch example with a similar intention and the role of local government in urban development. Wan and Noor (2005) find that partnership programmes in providing public housing in Kuala Lumpur have been successful. Likewise, Dato' Mohamad *et al*. (2000) exhibit a set of examples initiated in Kuantan that were deemed to be successful at the time. The Kuantan initiatives were part of an international network on PPP involving sister-cities under the auspices of the Konrad Adenauer Foundation of Germany.

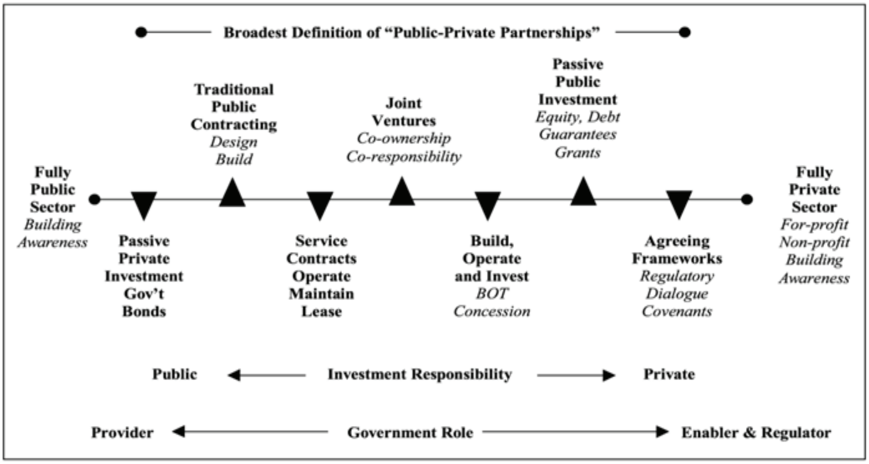
Despite its popular inception in Europe, PPP is not always successful. Examples from the Netherlands have shown that PPPs are not practical, particularly as partners are confronted with the difficulty of making joint decisions, and the organization tend to revert to traditional forms, that is, contracting out and separating the responsibilities (Klijn and Teisman, 2003). One of the reasons for the failures is expectations of large scale private investment in PPP. However, Klijn and Teisman (2003) claim that some weaknesses appeared at the last stage where squatters were offered opportunities to purchase housing units without the need to verify their eligibility, which is an important policy in public housing. This led to ineligible persons owning low cost houses that was meant only for those in the lower income category (Wan and Noor, 2005). The success of PFI/PPP in the transport sector depends purely on the comprehension of the policies concerned with it and a greater involvement of local authorities in future (Glaister, 1999).

Li *et al*. (2005) conducted a comprehensive empirical study on PPP/PFI projects in the United Kingdom construction sectors and found the key factors that emerge from their study were committed public agency, shared authority, cost-benefit analysis, stakeholder relationships, and strong private consortium. Among these, strong private consortium, appropriate risk allocation as well as available financial market were the most important factors. Heymans and Schur (1999) further stress the ingredients to successful implementation of PPP in the construction sector are "policy reform, legislative change, and robust public financial management".

Jamali (2004) cites the work of Gidman *et al*. (1995) to distinguish PPP from privatization (see Figure 2). The diagram distinguishes the role of the government from one of a provider into one of an enabler and regulator in the process. This is particularly crucial especially in the PPP undertaking by local governments where the idea of joint cooperation has shifted from one that is purely a contract given out to joint-ventures (which are relatively popular now), to the other extreme where public sector involvement is passive. In this regard, the involvement of the public sector is lowest when it forms passive involvement to becoming a regulator and enabler.

According to Batley (1996), little has been done to evaluate the performance of privatized entities, except in the fields of solid waste collection, and water and electricity supply. Likewise, literature in the field shows scant attention to the processes that are involved in the PPP. The only notable work is that of Fischbacher and Beaumont (2003).

Figure 2: Dimensions of Possible Relationships Involving Public-Private Sector Partnership




Source: Gidman *et al*. (1995).

In this paper, the focus is on the processes involved in the PPP projects involving local governments in two cities in Peninsular Malaysia. PPP is taken as a tool for cooperation between local government and the private sector to develop properties for the local government without any cost. On the contrary, such cooperation will be able to derive some revenue for the local government and enable the private partners to conduct profitable commercial activities. This is possible with PPP.

### *2.2 Government and Political Will*

Local governments fall into the third tier of government in the federation of Malaysia with the federal government taking the first tier and state governments the second. Under the federal constitution, local government comes under the direct supervision of the second tier government. Although elections had been held at the local government level even before it was extended to the federal and state levels, it was suspended at the local government level beginning 2 March 1965. Since then, the councillors for each of the 145 local authorities in the country are appointed by the ruling government affiliated political parties. The president of the local authority is appointed from among civil servants at the federal or state civil service. This justifies the use of the term "local authority" as being more appropriate than "local government" in Malaysia.

The appointment of local authority presidents has serious implications on the quality of leadership and service they provide to the local authorities. Presidents are expected to deliver exemplary results for the local authorities, but in practice only some leaders stand-out. These leaders could even spur economic growth in the city when others would leave it for natural economic factors to do so. There are some who have resorted to PPP as an effort to stimulate real estate development and economic growth. Some even look at this as an important measure to raise one-off revenue. Nevertheless, the president would have to submit the proposal to the council for endorsement before the plan is submitted to the state government for approval. Many other local authorities do not venture into PPP mainly due to lack of will, experience and zest in the leadership. Besides, the Privatization Master Plan issued by the Prime Minister's Department does not match the needs of the local authorities.

Political interventions in the implementation of PPP projects are always present. However, the local authority must adhere and practice strict compliance to rules and regulations. Political pressure may emerge from federal or state levels, most of the time as an attempt to influence the local authority president to accept a particular tender for the project. This forms another reason why most local authority presidents refrain from becoming active. However, in Malaysia, if a policy (including privatization) fails, it is common that civil servants are blamed. In fact, this can extend further if the privatization process crumbles completely. However, the cases discussed below do not deal with initiatives from politicians but of the local authority leaders who have the ability to lead the cooperation between the local authorities and the private sector.

## 3. Methodology

This study entailed an investigation into the details and processes involved in the PPP exercise at two local authorities in the peninsula, namely the Kuantan Municipal Council (KMC) and the Batu Pahat Municipal Council (BPMC), located at the Pahang and Johor states, respectively. The former also operates in the state capital of Pahang, turning the KMC into a key agency in the state capital in ensuring excellent and efficient urban services and development. Compared to BPMC, KMC on one hand is able to garner much support from the state administration particularly due to its position as the state capital administrator. On the other hand, Batu Pahat is a city that is comparable in population size to Kuantan. However, since it is quite a distance from Johor Bahru, the state capital of Johor, it is rendered less influential in getting special attention, unlike Kuantan.

The study uses both primary and secondary sources of data. KMC was chosen because the researcher was directly involved in documenting unfolding events of PPP which subsequently heralded the sister-city concept. This was later published in 2000 by the Konrad Adenauer Foundation based in the Philippines. This material has become the secondary source for KMC. The document exemplify PPP experiences in East and Southeast Asian local governments. Malaysia was represented by KMC, led by Dato' Mohamad bin Saib, the former president of the council. KMC also received a string of other accolades under his leadership, including some which are internationally recognized. A revisit to the initiatives would examine whether the initiatives continued even though the leadership of the council has changed. The former president subsequently became the Director General of the Department of Local Government under the Ministry of Housing and Local Government, Malaysia. Since retirement, he has made Kuantan his retirement home and is consistently in touch with the staff of KMC. Most of the primary sources of information were obtained from Dato' Mohamad bin Saib and through contacts with various officers in KMC.

BPMC was chosen after a search for a local authority with similar involvement in property based PPP initiatives. The search was initiated at the Kluang Municipal Council, but it was soon realized that their initiatives do not fit into the PPP concept employed in this paper. The search in Kluang directed the researcher to BPMC which was claimed to have had a bad experience in PPP (which fulfilled the intention of this paper). In the case of BPMC, permission to do the study was granted by its president. Hence, a few personal meetings were held with the officer who was involved in the PPP initiative to provide primary source data for BPMC, while concession agreement documents formed its secondary source of data.

## 4. Case Studies

This section examines the dynamics of the initiative between two local authorities and developers in Batu Pahat and Kuantan municipal area councils, as well as the subsequent post-project developments observed. The case studies clearly depict the successes and the failures from the PPP exercise.

### *4.1 PPP in Kuantan*

Kuantan, with a population of 403,416 in 2005, is the capital city of Pahang and is located at the Eastern coast of Peninsular Malaysia. KMC sees PPP as a means to boost privatization in areas under its jurisdiction. Similarly, privatization of land development is seen as an effective tool to enhance its function as a planning authority as well as the administrator of the city. It had, in the past, a number of joint ventures with the private sector which entailed the concept of PPP (Dato' Mohamad *et al*., 2000). In the two examples that follow, it can be seen that PPP has been a success in Kuantan. A number of PPP exercises have been initiated by KMC as a result of its confidence in PPP. However, in all the cases under its jurisdiction, the two key factors are land availability and initiatives led by its leadership.

The objectives set by KMC with regard to PPP initiatives are: (i) to spearhead development of infrastructure projects to enhance the quality of living and lifestyle of residents; (ii) to explore socioeconomic investment through privatization by creating business and job opportunities; (iii) to reduce dependency on tax revenues to finance urban services; and (iv) to support investment inflow into Kuantan. All these depict the proactive role of the local authority in influencing economic growth in the city.

Being part of the civil service, the management of KMC took special note of being accused of corruption if they work together with the private sector. Hence, tender procedures and selection of developers were given special attention. KMC either called for an open tender for projects identified or invited proposals from developers on a "first-come-first-served" basis. The procedure involved in the PPP listed in this paper entails the former, as illustrated in Figure 3.

The activity involving privatization at the local authority is closely vetted, especially by the state government, which acts as the statutory guardian of local authorities. This is to safeguard the interests of the public with regard to the services provided by the local authorities and avoid projects that are wasteful. The involvement of the federal government, through the Economic Planning Unit of the Prime Minister's Department, is to ensure that procedures comply with guidelines already set by the Unit in 1985.

In addition, KMC also vets the background of the company including appraising its management expertise, financial strength, intention of the proposed development projects, strategies to be used in marketing the products, and viability prior to awarding the contract to the successful bidder. The returns and benefits to all parties concerned are stipulated in the contract.

Kuantan has been known to be a strong advocate of PPP. This can be seen in a number of projects. To portray the PPP exercise in Kuantan, this paper examines KMC's experience through two specific cases.

### *The Development of Kuantan Centre Point*

The Kuantan Centre Point involves a two-acre plot of land located in Jalan Hj. Abdul Rahman in the central business district. The land was purchased from the state government for a nominal value of RM1,000, and originally housed a temporary town bus station with nine units of food stalls and 20

Figure 3: Tender Procedures for Bidding

| Step | Activity |
|---|---|
| 1 | Endorsement of the privatization project and related policies in Full Board meeting |
| 2 | Endorsement of project by State and Federal Government |
| 3 | Privatization Committee vets the tender documents |
| 4 | Privatization Unit advertises the project, calls for interested parties |
| 5 | Interested developers submit proposal |
| 6 | Privatization Committee at LA opens the tender box after deadline |
| 7 | Privatization Committee selects the best proposal based on a set of criteria and endorses all conditions of the offer |
| 8 | Full Board meeting endorses decision of Privatization Committee and agrees to award the project to the selected developer |
| 9 | Privatization Committee endorses the draft agreement prepared by the developer |
| 10 | Full Board meeting decides on the Agreement |
| 11 | State Government meeting endorses the privatization project and the development plan |
| 12 | Signing the agreement between KMC and the developer at Full Board meeting |

Note: LA - Local Authority.
Source: Dato' Mohamad bin Saib *et al*. (2000: 115).

units of petty trading stalls. The stalls were previously built by KMC: the food stalls were rented out to operators and the petty trader stalls were leased *en bloc* to a private enterprise for a three-year term. The areas around the land are owned by the Pahang State Economic Development Corporation. As large shopping complexes sprang up in the neighbouring lands, KMC felt that the two-acre plot should also be redeveloped. However, the local authority had neither the financial capacity to build using its own resources nor the expertise to be a developer. As a result, it planned to enter into a PPP with the private sector. This venture received the approval of the state government. At the Full Board meeting in December 1995, the management suggested that the re-development plan should focus on encouraging small and medium scale enterprises in addition to letting office space that was very much in demand then.

KMC subsequently invited interested parties to submit their pre-qualification open tender through an advertisement in local newspapers. Of the 20 companies that showed interest, only five were shortlisted, and given time to submit their proposals. The proposals were required to show designs for food court, business and office lots, stipulate returns to KMC and estimate post-development value of the property. Among other things examined in the proposals were aspects such as layout and building plans, furnishing, returns to KMC, benefit to residents/communities, viability of project and features of company background. The developer's background (financial and experience) and each item above were assigned some points, the sum of which forms the total score for the proposer. It was decided that the proposal that received the highest points would be awarded the project.

EDSB (full name withheld for confidentiality) was awarded the project, and the decision to select this company was approved by the council's management and the Full Board meeting. The proposal was to construct a RM57 million business complex consisting of three blocks. In addition, the developer was to construct the required number of stalls on a temporary site to relocate entrepreneurs currently operating in the complex. Returns to KMC were projected to be 15% of project value, that is, RM9.9 million. In addition, KMC was allocated office space from the fifth to the eighth floor in the complex.

In order to ensure that the envisaged physical development took place within the stipulated time, the developer was required to place a bond of RM22,800 with KMC in addition to a bank guarantee of RM1 million and the director's personal guarantee. Furthermore, a fine of RM2,280 per day in delay completing the project was also imposed in the contract. Above all, under no condition was the developer allowed to mortgage the property to secure a loan.

In order to ensure financial sustainability and accountability, all proceeds from the sales of the property were to be deposited into a common account. Expenditures incurred requiring payment from the account were endorsed by both the developer and the KMC as signatories. The developer was also required to produce monthly reports on the progress of the project to KMC, and this was to include areas such as finance, progress of development and delays.

Besides the need to strictly comply with approved plans, meetings were held fortnightly with the developer's team to identify bottlenecks and hitches in the construction process. The project commenced in June 1996 and was duly completed with the issuance of Certificate of Fitness of Occupancy in December 1998. After this date, the developer began to work on the management of the complex, and was allowed to charge tenants as provided for in the contract. The developer was also responsible for promoting the complex.

To date, there appears to be no setback in the relationship between KMC and the management of the complex. KMC receives more than RM230,000 per year as rental from the units given to it. Revenue from licensing and assessment taxes adds to this figure.

*Renovation and Leasing Part of Kuantan Central Market*

Supermarkets in Kuantan in the early 1990s were relatively small in size and none exceeded a built-up area of over 20,000 square feet. The range of products offered in the supermarkets was limited and expensive. Many residents chose to travel to Kuala Lumpur or Singapore to purchase quality goods, furniture, fittings and appliances.

Acknowledging the lack of economic attractiveness in Kuantan, KMC mooted an idea to renovate the market. Some of the problems were traders operating market and food stalls under conditions that were not hygienic, and the place was quite disorganized. This scenario posed a serious problem to the municipality and needed quick remedies. However, KMC was not willing to use part of its revenue to cover the cost of introducing any new development. Once again, PPP was seen as the plausible solution. As Ocean (Kuantan) Sdn. Bhd. (OKSB) was a tenant operating and occupying the largest commercial space on the first floor of the market complex, a contract was awarded to the tenant to renovate the market, including building a new block, renovating the first floor of the market as well as to construct 138 petty-trading stalls nearby, bearing a total construction value of RM5 million. There was therefore no necessity for a tender process or the involvement of "first-come-first-served" basis proposals. Upon completion, OKSB was given a lease to operate a supermarket exceeding 100,000 square feet for 15 years. The supermarket was the largest in Kuantan then. KMC received RM39,000 per month from the lease, excluding taxes and revenue from licensing.

With the development, the marketplace became pleasant and provided more earning opportunities for petty traders. Later, OKSB sold its stake to The Store – a supermarket chain. To counter the inception of the new "large supermarket", some smaller complexes operating in Kuantan were naturally forced to renovate and upgrade their facilities for survival. Others moved into larger shopping complexes. People benefited from this development and the spate of economic growth that emerged.

However, the rental of space was low since the inception of the new "large supermarket". Towards the end of the 15-year lease period, KMC realized it was time to review the rental value of the property to be commensurate with the current market rate. Faced with this new demand, there was initial resentment from the private sector partners. After some negotiations, both parties accepted the terms and a win-win situation prevailed. As KMC acted as an agent of development, it secured a higher rental value of RM55,000 per month beginning 2009 while the operator was given a longer concession to operate.

In both cases above, there was an external force that impacted on the relationship between the parties involved in the PPP exercise. During the Asian recession period in the late 1990s, businesses were badly affected including those in Kuantan. Vacant commercial lots increased and the complex and supermarket that underwent the PPP exercise were also affected.

However, KMC began to take proactive steps to help the operators of both premises. Using its close relationship with public agencies operating in Kuantan, it began to attract them to move into the affected premises. A strategy to achieving this involves hosting events such as cultural shows and expositions that attracted more customers to the complex. To help further, KMC also offered discounts on rentals, not only in the two premises but also in other business enterprises.

PPP has certainly been fruitful and beneficial to KMC in terms of its revenue. Of about RM92 million obtained by KMC as total revenue in 2008, RM2.5 million (2.7% of total revenue) was obtained from PPP activities. At the same time, PPP has shown to be a smart contributor to KMC in developing and spurring economic growth in Kuantan and at the same time, reducing domestic leakage in spending elsewhere. Today, Kuantan boasts of a number of large shopping complexes that attract people from surrounding areas, including the southern part of neighbouring state of Terengganu. This can be witnessed on Fridays when many people from Terengganu travel to shop at Kuantan.

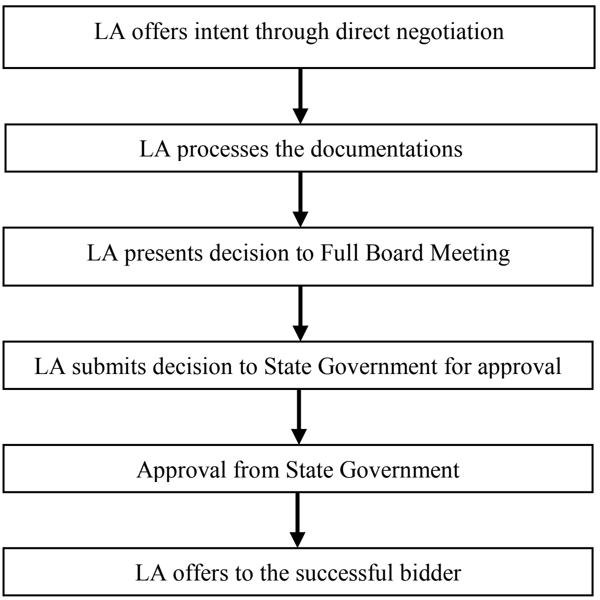
### *4.2 PPP in Batu Pahat*

This case study relates to the Menara Majlis Perbandaran located at Jalan Rogayah in Batu Pahat, a city in Johor with a population of 363,413 in 2005. The site was formerly a bus station that was badly disorganized as buses and taxis were parked haphazardly, with a number of hawker stalls that cater for passengers scattered around. In addition, the site was deemed underdeveloped as the surrounding areas and within the bus station was unclean and not attractive. The BPMC which owned the land felt the need to redevelop the site to ensure a systematic traffic system. Also, there was a need to move hawkers into the complex to ensure that their operations do not obstruct traffic flow. Thus, the BPMC decided that there was a need to redevelop a 15-storey complex which was to house bus bays, taxi stands, food stalls, public vehicle parking space and office lots. The council itself did not have the financial resources required to rebuild a complex of this size. Even if it did, approval from the state government was necessary before the resources could be utilized for this purpose, and quite often, this approval was not easy to obtain. The other option would be to apply to the federal government to fund the development. However, federal funds for development are usually given to build infrastructure and utilities as well as to maintain the existing facilities, and funds provided cannot be commensurate with the size of funds required for redevelopment. In addition, local authorities would normally refrain from opting for commercial loans [which was allowed by the Local Government Act 1976 (Act 171)] supported by the state or federal governments. Thus, the BPMC decided to privatize the project.

The objectives of the BPMC in the PPP initiative were: (i) to redevelop the existing facilities to be more organized and to provide a public transportation hub facility in the city; and (ii) to encourage better economic activities around and within the building.

In this exercise, the council entered a direct negotiation agreement with a private developer ABEEI (full name withheld for confidentiality) based on the PPP concept (see Figure 4). As mentioned earlier, leaders of public organizations in Malaysia can opt for direct negotiations or one that is based on open tender.[2] In the BPMC, obviously the former was chosen, most likely because of the relative simplicity of the process and the known track records of the private sector party. In a direct negotiation, it is usually

Figure 4: Flow Chart of Procedure in the PPP Activity at BPMC Centre




Source: Author.

accepted that the negotiating private sector party must have the necessary expertise to undertake the required service delivery for the government (Heymans and Schur, 1999). Based on the reputation and the success story of ABEEI, especially in one of the many cases involving PPP in Kuantan – a bus terminal project (Dato' Mohamad bin Saib *et al*. 2000) – the management was determined that the developer would be in the best position to take up the offer. Both parties closed an unthinkable 60-year concession agreement in 1993 where the council land became the collateral. The developer was to construct, develop and complete the development using his own resources. The concession period appears to be too long, as if the management and the council are placing liabilities on the next few generations to handle the project during their times. This is very peculiar when compared to many international experiences that usually cover between 20 and 30 years only (Hodge and Greve, 2007). The cases in Malaysia usually require the bidders to propose a comprehensive plan of the project as it is believed that the private sector is more innovative and able to propose innovative ideas. This is supported as they have more resources. Also, the architects, engineers and town planners at the local authority are unwilling to take the full responsibility to propose a plan, which may be subject to public scrutiny and embarrassment later. Besides, local authorities are usually short of qualified planners.

The developer produced the proposed design which was vetted by the management and duly approved by the Full Board council meeting and the state government. BPMC facilitated assistance by accelerating the approval process of the development plan. Continuous discussions were held with the developer (especially the engineers) to facilitate progress, and numerous stumbling blocks were jointly addressed by both parties. The council also monitored the progress and advised the developer during the development process.

The developer gave an assurance that the council would gain substantially by this initiative. Upon completion of the construction, the developer built 25 bus bays on the ground floor, 60 units of food stalls on the third floor and 79 taxi bays on the fourth floor to the council. None of these, except the food stalls, earned revenue for the council, and even then it was only a meagre amount that was charged for licensing. The units that carried more commercial value, that is, the remaining floor spaces, were assigned to the developer (see Table 1). In this sense, the agreement appears to be lopsided in favour of the developer. The local authority was glad that previous social and infrastructural problems associated with the building were able to be addressed by the undertaking. It is believed that the local authority did not place great emphasis on immediate financial returns. This reflected a lower expectation from PPP by the BPMC when compared to the cases in Kuantan.

Table 1: Floor Spaces Assigned to Developer

| Floor | Use | Floor Space (sq. ft.) |
|---|---|---|
| Ground Floor | Shopping complex | 13,800 |
| 1st Floor | Shopping complex | 41,232 |
| 2nd Floor | Shopping complex | 40,735 |
| 3rd Floor | Shopping complex | 22,147 |
| 4th Floor | Shopping complex | 19,026 |
| 5th and 6th Floor | 271 units of parking bays | |
| 7th to 15th Floor | Office space | |

Source: Author.

One of the perks assigned to BPMC was that profits from the car parks managed by the developer were shared 60:40 with the council taking the largest share. The complex is to be owned by the council after 60 years. The developer had the right to sell the property that has been assigned to ABEEI. In practice, only 14 storeys were completed. The office spaces on the 7th to the 12th floors were rented out. The council purchased four floors (11th to the 14th) for RM4 million as stated in the agreement, and was to pay management fee after completion of the construction. Some of the remaining floors have been rented out by the developer, but some continue to be vacant to date. ABEEI maintained the property as the caretaker prior to the passing of the Commissioner of Buildings Act (COB) in 2008, although the agreement made both the council and the developer as joint caretakers. The COB Act 2008 required public properties such as this complex to set up a management corporation and an independent account with membership comprising owners of the property, including ABEEI and the council.[3]

Problems in the "marriage" began to emerge in 1996. Firstly, the council failed to pay the developer a management fee. The council justified its action with the claim that it had not occupied the premises and therefore, not liable to pay the management fee until they occupy the premises later. This is awkward as it is common for councils to charge property owners assessment tax even when the building is under construction. In response, the developer declined to pay assessment tax due to the council. The management fee was to start from 1996 and total management fee now exceeds total assessment tax due to the council.[4] The council charged tax from the date the certificate of fitness was approved for the complex, that is, from the beginning of 1996.

BPMC could only collect taxes from units sold to private investors and occupants. The council was willing to move to the complex with the view to catalyze the shifting of other interested parties into the complex, including private enterprises, government agencies and others who may be interested in occupying the office spaces. It has to be noted that the council has been occupying the 11th to the 14th floors, which they had purchased for RM4 million, since 2006.[5] However, ABEEI was said to be unwilling to negotiate further and had no marketing plans to persuade interested parties to move into the complex.

ABEEI has offered to take over the ownership and management of the whole complex, but BPMC could not accept the offer as it would involve a significant overrun of its funds. As a counter reaction, the council took legal action against the developer in 2008. The developer claimed that their non-payment was due to the council's failure in paying the management fee.

ABEEI has also been facing problems with customers and other tenants in the complex. Due to lack of confidence in the management and lack of cleanliness in the complex, many tenants refused to settle the management fee. As a result, ABEEI did not settle electricity bills with Tenaga Nasional Berhad (TNB), the national electricity supplier. This resulted in TNB disconnecting power supply to the common areas that affect customers and tenants of the complex.[6] Elevator services were disrupted and the lifts were not maintained for some time. Eventually, the lifts had to be serviced by the council. Further more, since air-conditioning is centralized up to the third floor (including the premises of the supermarket), many businesses were affected when the centralized air-conditioning failed. As they were dissatisfied with the episodes, some tenants in the complex left to continue their business elsewhere.

To avoid further grievances to all parties, BPMC and other tenants have successfully negotiated with the developer to reinstate electricity supply. The council facilitated and encouraged the tenants to pay up arrears to the developer to help address the problems faced. However, it is unclear whether the council paid its portion to ABEEI.

One interesting aspect in this exercise is that the council allowed the developer to mortgage the land to secure a loan facility from a commercial bank to finance the development of the property. Following the national policy, 30 per cent of the shop lots were to be allotted to Bumiputeras. The exercise also allowed the developer to enter into sale of units under the Strata Titles Act 1985.

The third problem arose when it was learnt that the developer had mortgaged the title a second time to refinance their loan facility. The council takes the view that it cannot be held responsible if the developer goes bankrupt or if there are any default payments. BPMC filed a civil suit in 2004 demanding the developer to settle or service the mortgage, and return the document of the said land to BPMC free from any encumbrances. ABEEI obliged and the document has since been returned to BPMC.

The council also faced another problem with third parties. The former bus station and taxi stand as well as the 30-odd food stalls belonging to the council were offered a temporary site at Jalan Omar during the redevelopment process of the complex. Upon completion of the new complex, some of the stall operators at Jalan Omar refused to move to the new complex. Apparently, those who chose to remain, benefited more than those who returned to the complex.

This case is an example of risks in a PPP exercise, but the problem is in the manner with which the exercise was initiated and weaknesses in the selection process. The selection of the developer was not done via an open tender and it is not known whether the background of the developer was thoroughly investigated. KMC performed this task very diligently. The risk posed by the BPMC case is that the council is likely to take on the burden of administering and maintaining the facility in the future, thus, concurring with the views of Grimsey and Lewis (2004). The soured relationship has already indicated that the developer is unwilling to pursue further with his responsibilities, and it is believed that this relationship will not last. BPMC has also allowed the developer to mortgage the land – a move which KMC carefully refrained from. However, the fault should not be placed on the developer alone. BPMC had in the first place breached the contract by not paying the management fee. The developer merely retaliated when he refused to pay dues to the council and defaulted payment to utility companies. The situation is somewhat complex as this facility has units that have been sold to private individuals; the souring of the relationship between the council and ABEEI has also affected them. They were saved in time by the Commissioner of Building Act, 2008 which brought together all concerned parties in managing the asset. The experience in BPMC has in fact led to fear among other local councils in Johor in PPP dealings.

The undertaking is very different from Kuantan's. The BPMC did not enter into a guarantee to be placed with the local authority, proceeds were not deposited into a common account to be signed by both parties in the PPP exercise, and there was no indication of penalties if there were delays in the construction of the facility.

## 5. Discussion

As only three cases are discussed, it may be inappropriate to generalize on the findings. However, the paper sheds some light on some of the pertinent issues in relation to the partnership exercise, in particular the PPP, involving local authorities in the country. The three examples have shown that there is no need to depend on public expenditure to involve the private sector on joint ventures that would benefit all parties involved. Although this can be considered a way of saving taxpayer's money, a broader picture is that it incorporates the role of the private sector in economic development at the local level, and there is certainly a significant role played by local authorities in creating economic spin-offs. It has been common that such initiatives were more embodied within the scope of the federal government. Despite that, not all local authorities undertake this exercise. Kuantan has been a proven case and is a very popular destination for practitioners of PPP. In Johor, even among the larger local authorities where leadership, skills and expertise co-exist, not many local authorities undertake PPP. In fact, it has been noted that local authorities in Johor were sceptical of the potentials of PPP. The problem faced by Batu Pahat is often mentioned by the leaders of other local authorities in the state as one of the reasons why they would not opt for PPP. The situation in other local authorities across the country is however unclear.

PPP has been equated to the term "marriage" in this paper, and this is warranted looking at the experience that appears to both extremes. While KMC and BPMC, both local authorities of almost equal status, have decided to get "married", the experience of the former illustrates a successful marriage while the latter has ceased to work. Therefore, what made the marriage work or otherwise needs further examination.

Unlike in Batu Pahat, both the cases in Kuantan did not involve giving up of land titles, thus, there was no mortgaging involved. All financial matters were purely dependent on the financial strength of the developer. The initiatives would have failed if the financial background of the developer was poor. Whatsoever the case may be, KMC still holds the title to the land, therefore there would be no possibility of financial institutions taking legal action to claim ownership of the land or the property given the operator continues to default payment. The mortgage process in Batu Pahat has led to the developer having an extra edge to default payment, likely leading to a situation where the council would end up losing the land and the premise to the banker. Today, KMC still holds to the strong belief that the land title should never be ceded to the developer. This appears to be the major difference between both cities in their implementation of PPP.

The case in Kuantan appears to be more balanced in sharing responsibilities, but more lopsided in Batu Pahat. The former is called "strong PPP" and the latter "weak PPP" following Van Boxmeer and Van Beckhoven's (2005) description of PPP. Strong PPP is one that has equal involvement of both parties and one in which decisions and powers are shared; this is the opposite in a weak PPP. Following Grimsey and Lewis (2004) and Li *et al*. (2005), Batu Pahat is a good example to show the risks that are involved, especially in the post construction management process and the likely long term unexpected challenge to public sector.

As mentioned earlier, there were striking features in Kuantan where the leadership had played an important if not the most significant role in leading the initiatives with courage and wisdom. The leadership of the council was known to have been so exemplary that subsequently, in addition to other accolades, the president was made the Director General of the Local Government Department, Ministry of Housing and Local Government. Like in Kuantan, leadership was said to be the driving force in Batu Pahat in introducing PPP. Internally, the introduction of PPP was not easy as there was a need to convince the Full Board meeting of the local authority and the staff to accept the new paradigm of PPP which was initiated alongside the introduction of ISO9000.[7] It involved a series of painstaking efforts in planning, meetings, consultations and negotiations which required full support from the management, otherwise the exercise would not have materialized. Therefore, transparency in the process was evident as advocated by Hodge and Greve (2007). Kuantan has provided proof that a complete and continuous follow-through is ultimately necessary in ensuring that the "marriage" works. The cooperation and contribution of various levels of individuals at the KMC was vital. Frequent meetings held among the staff were also required to examine the status of the initiative and in identifying bottlenecks. Some of these aspects also existed in Batu Pahat. The cases examined showed greater commitment of various parties in ensuring the success of the initiative in Kuantan than in Batu Pahat, which is also consistent with the recommendations put forth by Hodge and Greve (2007) and Li *et al*. (2005).

The Kuantan experience reveals that local authorities should behave in a manner that would be conducive to enhance good relationship with the partners in PPP. Batu Pahat has taken it somewhat quite to the opposite, and there was a tussle between both parties involved in settling payments to each other. This has led to one partner blaming the other, and the tenants, business operators as well as the customers patronizing the complex being redefined as the victims from the standoff. In the marriage within PPP, a softer approach in communication is vital. In other words, PPP is a long term relationship and depending solely on an agreement per se may not work. Batu Pahat has seen the divorce between the council and the developer. Sustaining the relationship would require perseverance, cooperation, helping-out, good communication, support of various parties, and also experience (Hodge and Greve, 2007). Learning from the experience of others is also vital.

PPP may not mean anything to petty traders. What matters to them is the success of their businesses. The case in Kuantan showed that moving the petty traders while a new set of hawking facilities were built did not receive objections like the case in Batu Pahat. At the latter, a number of petty traders refused to return back to their original site as the temporary site turned to be a more strategic location. Likewise, the term PPP did not carry any weight for the general resident. In fact, the residents could not even understand the meaning of it even if it was advertised as required on the sign postings informing the public about the project. To the residents, it does not matter whether the facilities were provided under privatization, out-sourcing, PPP, contracting-out or any other terms. Like the petty traders mentioned above, what matters to them is that the services provided should benefit them and it does not matter who provided them and through which means.

## 6. Conclusions

With regards to local government's effort in getting the private sector to participate towards inducing development, this paper has discussed a few points as lessons for all parties concerned, especially local governments elsewhere around the world. The paper has also shown that PPP is workable and would benefit both parties, let alone the urban residents. A point to note is that land ownership by the local government is essential to allow for PPP in real estate development. Some local governments may not possess the sizeable land that is required – at least one to three hectares. Hence it is pertinent that interested local governments identify land for this sort of exercise. In Malaysia, local authorities may persistently apply for land banks from state governments to be given to them as part of the state government's social responsibility to the citizens. Otherwise, local governments should consider purchasing land now for future use which would prove to be beneficial in the long run.

For local governments that have land banks, the cases shown are sufficient to take cognizance of the fact that land title should not be allowed to be mortgaged by the partnership as collateral for financial assistance. The case in Batu Pahat has shown adverse effects when the land was mortgaged twice and the council had to resort to take legal recourse to retrieve the land title.

In carrying out and implementing successful PPP, leadership and full commitment of the management is absolutely necessary. In addition, leadership should be retained on a long term basis, otherwise successors should ensure that the PPP initiated before their term of office continues to work during their tenure. Leadership is very important in local governments as subordinates will not react if there is no clear guidance from the new leader. Absence of clear leadership support would prove the PPP exercise to be futile and a waste of resources. Once these elements are there, it is also important that a good relationship is fostered between both parties, akin a marriage where communication, understanding and tolerance is ultimately required. No party in PPP should behave in such a way as to show one is more dominant than the other.

Finally, it is important that local governments understand the difficulties faced by the partners in PPP. Local government leadership should be prepared to negotiate anytime during the concession period to be of assistance to their partners in the private sector. This would not only reduce the private partner's difficulties, but also, increases their trust and spirit of "partnership". These elements have not been identified as important in the literature (Hodge and Greve, 2007). In general, the major benefits of PPP are greater involvement of the private sector in the provision of public services; reduced public expenditure; and greater risk-taking by the private sector partners and increase in revenue and physical assets to the local government.

## Notes

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2. In current terms, the government does not favour direct negotiations as it has received numerous public outcries over such arrangements in the past.
3. The federal government has just finalized and approved the posts for Commissioner of Building to be placed at the local authorities.
4. It is common that the management fee is significantly larger than the assessment tax for a multi-storey property.
5. The units were empty before 2006.
6. Tenants are supplied with individual meters. Common areas include walkways, air-conditioning, escalators, lifts, restrooms.
7. Coincidentally, quality accreditation and PPP took place with the intention to completely revamp the way the local authority was providing urban services. Serious involvement of the local authority in enhancing as well as supporting economic development was imperative. Paying attention to one aspect and neglecting the other was not practical in the long run to sustaining positive results.

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