



# Innovative Implementation of Private Finance Initiative (PFI) Procurement: Challenges and Key Issues in Pre-Construction Stage

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## Abstract

Private Finance Initiative (PFI) has been successfully implemented across the globe, however regarding the implementation process; the PFI arrangements are not similar from country to country. Based on the circumstances, this paper investigates the key issues and challenges of PFI implementation in a pre-construction stage in Malaysia compare to other countries. This paper will present the results from a semi-structured interview conducted on key PFI expert group with interesting outcome include the critical issues of relationship and financing. The findings will promote an innovative PFI implementation in pre-construction stage and also innovate industry players in making best decisions.

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Keywords: Private Finance Initiative; Implementation; Relationship; Innovation.

## 1. Introduction

Private Finance Initiative (PFI) was formally begun in the United Kingdom (UK) in 1992 under the reign of former Prime Minister John Major (Broadbent & Laughlin, 1999). It is a continuation of the privatization policy that has developed under the rule since 1979 Margaret Thatcher. Thus, countries such as Australia, New Zealand, Japan, Singapore, Canada, Italy, Portugal, Norway, Finland, America, and South Africa have followed and used PFI as a procurement system. It can provide, among other advantages, value for money, distribution of risk, and innovation, to the government. Moreover, innovative PFI implementation would enhance the behavioral aspect of a relationship between industry players. Accordingly, under the administration of Tun Abdullah Ahmad Badawi, PFI in Malaysia was launched in 2006, which also is a continuation of the privatization policy introduced in Malaysia in 1983. Implementation of the privatization program in the past two decades has provided a foundation for cooperation

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between the government and the private sector. Privatization program also contributed to increased private sector participation in the economy and thus make the private sector to spearhead economic growth. However, some aspects of the privatization program should be streamlined and improved to make it more efficient (Norwawi, 2006).

Continuity of these phenomena by EPU (2006), PFI has been used in two circumstances. First, PFI can make the implementation of government projects more efficiently and balance the risks and rewards of partnerships between governments and the private sector. Secondly, PFI can be used to focus government assistance to improve the viability of categorized private sector projects in strategic or promoted areas. Among the projects identified by the government that can be implemented using PFI include transport infrastructure, services and educational development (Syuhaida, 2009). With strict implementation, PFI will reduce the cost of ownership are to be borne by the government and encourage private sector investment in regional development and the identified areas.

## 2. Literature Review

### 2.1 PFI Implementation in Malaysian Construction Industry

The purpose of PFI is to level the close relationship between the government and the private sector, including for the federal government and local authorities. According to Khairuddin (2009), PFI is an alternative to public procurement strategy. PFI refers to the delivery of public services assets that are previously undertaken by the government and now will use the funding and expertise from the private sector jurisdictions. In Malaysia, the government has adopted the PFI with the aims to ensure the projects that are carried out by the private sector can complete quickly. At the same time, the government implements the concept of capacity to pay first, and also to ensure that social projects such as schools, roads, and hospitals can be conducted and completed by the private sector. It is necessary to achieve value for money and project risk should be borne by both parties. Before the Ninth Malaysia Plan 2005-2010 (9MP), Tun Abdullah had established Pembinaan BLT Sdn. Bhd. in 2005, with the aim to control the development and implementation of construction of quarters and facilities for the Royal Malaysia Police across the country (Khairuddin, 2009). This idea was to see a practical application of this project using PFI approach, which is called build, lease and transfer (BLT). The success of this project will also serve as benchmarks for the implementation of PFI projects under 9MP. In line with the policy to strengthen public-private partnership, the government is actively implementing PFI to stimulate private investment.

The government has identified projects worth RM20 billion, undertaken on BLT approach. Funding obtained from the Employees Provident Fund (EPF) and the Pension Trust Fund (PTF), which will have assets built for rent back to the government. Among the projects that have identified includes schools, quarters, and office buildings. Besides, the PFI Facilitation Fund worth RM5 billion has been injected to support projects identified by the private sector with extensive branching effects on economic growth (UKAS, 2009). Under this method, the private sector will bear the full risk of the project while the government only provides financial support to enhance project viability. Among the supports provided include sponsoring students to private institutions and provision of land and necessary infrastructure. The government also could purchase or lease a new building built by the private sector in the city to ensure the viability of the project (EPU, 2006). There may be confusion in the setting of PFI Sdn Bhd in which Employee Provident Fund (EPF) has injected RM260 billion investments at RM12 billion per annum in the said SPV (Special Purpose Vehicle). Projects implemented under this scheme may not have the key features of PFI as illustrated in Figure 1. According to Tay and Partner (2006), seemingly, PFI is not different from previous privatization models. Both involve the public sector tapping the expertise and efficiency of the private sector. But under PFI, the private sector's revenue must commensurate with the quality of services it provides. Hence, the clear elucidation of accountability as an essential principle in PFI represents a paradigm shift in Malaysia's privatization landscape. Evolution of the PFI in Malaysia is a learning point for a variety of factors to ensure successful PFI in the construction industry (Khairuddin, 2009). Integration between the government and the private sector in carrying out a project has enabled the country to make a profit, typically to improve the construction industry and the economy.

PFI has been a part of the construction industry since early 2005's. However, the building project by using PFI cannot avoid having problems especially when it newly introduced in the industry. By implementing new

procurement method, there will be serve consequences when the projects begin due to lack of knowledge vague understanding of the procurements perceptions (Shamsida & Abdul Rashid, 2009, Izatul Laili Jabar et. al, 2015). To make it worst, the PFI implemented in Malaysia is diverse from PFI implemented in the UK. Roshana et. al., (2009) and Shamsida & Abdul Rashid (2009) mentioned that PFI concept adopted in Malaysia doesn't follow the basic criteria of the International PFI framework that had tested in many developed countries such as Australia, UK, and Europe. As a result, local government and private sector will be having a huge problem whenever setbacks arise during the construction due to lack of information regarding how to solve the issues. According to Yong (2004), more than 140 countries around the world are using PFI as a catalyst for the construction industry projects that have not implemented due to lack of financial sourcing and capacity. However, PFI implementation is not same between one country and another (NAO, 2003). Also, according to Kok (2006), the differences regarding politics, economy, social, and law between the countries have also resulted in the lack of a blueprint or plan on how to ensure the successful implementation of PFI projects. Thus, each government should plan their implementation programmed based on their respective suitability and available capacity. So, based on this phenomenon, the aim of this research is to determine the key issues and challenges of the difference in PFI implementation in Malaysia compared to other countries.

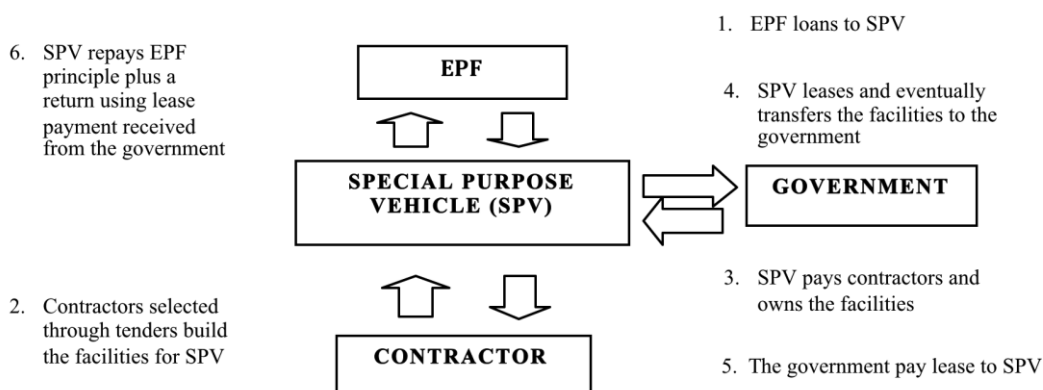


Fig. 1. Proposed PFI Structure with EPF Funding  
(Source: The Edge Daily, 2006)

### 3. Research Methodology

According to Mohamad Fadhil Mohamad et. al, (2014), research methodology paves the way for managing research methods appropriately and guides the researchers on methods to be applied to collect and analyzed data. This study was undertaken to gain insight and in-depth knowledge from multiples respondents to enhance the behaviours aspect of a relationship between industry players. On this research, there were two methods used to obtain the data: semi-structured interview and case studies. A semi-structured interview was conducted to get the data and information about the implementation of PFI projects in Malaysia in more details. In this study, sampling based on a critical case where respondents are chosen on their characteristics required to provide the best information to achieve the research objectives. The interview conducted with respondents who were selected based on expertise, experience, and knowledge in the implementation of PFI projects. According to Birrell (2002) the characteristic of respondents should be good at the making decisions and have the experience and expertise in running a project. This is consistent with Schmidt et. al. (1986), that the importance of experience in controlling the quality is on par with other studies in which work experience provide a high impact on the scientific work and the efficiency of its work. The respondents were senior management in government agencies, implementing agencies, bankers, consultants, and workers in the private sector who had involved in the exercise of PFI projects in Malaysia.

Next, case studies were conducted to identify the practical implementation of PFI projects in Malaysia at the pre-construction planning and tendering processes. According to researchers, the evolution of PFI in Malaysia can be divided into three levels namely PFI Mode 1, PFI Mode 2, and PFI Mode 3 (Refer Figure 2). For each level, three projects were selected.

In the case studies, several approaches were used namely data collection by using observation, interviews, case studies, and documents analysis. In this phase, a multiple case study will be conducted. The selected project to be analyzed will be in the pre-construction stage. More than one case is used in order to gain a better understanding of PFI implementation. In the observation method, the researchers examined the process of implementing the project from the beginning. Next, interviews were also used in this case studies method to obtain data by submitting a few questions specific to the respondents who directly involved in the project. The researcher has also used the resources obtained from the documents, findings, and guidelines for each project under review. The analysis of the qualitative data generated in interviews was conducted using content analysis. The method of content analysis enables the researcher to include large amounts of textual information and systematically identify its properties, such as the frequencies of most used keywords by locating the more important structures of its communication content. Such amounts of textual information must be categorized to provide a meaningful reading of content under scrutiny. Meanwhile, cross case analysis were used to analyzed data from case studies. Further, the results of research findings derived from the study interviews and case studies will be undergoing validation to test and assess whether the research is to achieve the acceptance by the industry. In this research, the industry involved in the verification of the proposed framework consisted of industry players who have expertise, especially those who were involved with PFI projects (Shamsida, 2013).

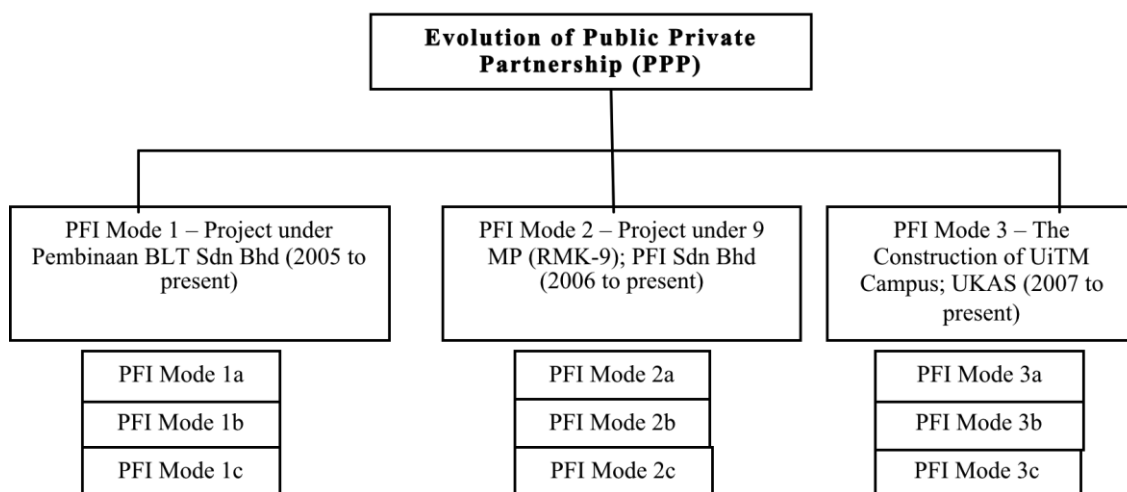


Fig. 2. Case studies conducted by researcher

#### 4. Discussion: Key Issues and Challenges

The following is a discussion based on the key issues and challenges identified by an analysis of the literature review, semi-structured interview, and case studies.

##### 4.1. Stimulate private sector investment

PFI projects have helped stimulate the growth of the construction industry in Malaysia. From the interviews, all the respondents agreed that through the implementation of PFI procurement, employment opportunities have been generated, and economic growth has stimulated. The implementation of PFI in Malaysia is also consistent with the

implementation of PFI in other countries such as the UK, Japan, and Australia. It is compatible with the findings made by Akintoye et. al., (2003), KPGM (2007), Yeoh (2007) and Ōnishi (2009). According to them, the implementation of PFI projects could indirectly stimulate economic growth.

#### *4.2. Financing Mechanism*

The results demonstrate that PFI projects Mode 1 and PFI Mode 2 are funded by the EPF and PTF while PFI Mode 3 is fund by the Development Bank. These financial resources come from the government companies. This finding is contrary to Boussabaiine (2007), Jefferies et al., (2008) and Partnership UK (2006) who stress that the PFI projects should fund by the commercial banks and financial institutions identified by the private parties themselves. In the UK, the private sector will organize their financing through loans from the banks, bonds, and equity to finance the costs of design and construction facilities and then provide services for PFI projects (Akbiyikli and Eaton, 2005 and Cartlidge, 2006). However, this phenomenon is far from PFI implementation in Malaysia because the source of funding for PFI projects come from the initiative of the government agencies as well and not from commercial banks (Zarina et. al, (2014). According to the respondents, financial institutions are not ready to give a commitment to PFI project that has long concession period. In his experience in project finance, many financial institutions are only willing to fund a project for duration up to 15 years. More than that period, the bank will make a restrict condition follow such as deposit payment and debt restructuring (the company should resolve old loan before making the new loan) from a financial institution before they can give a commitment to the project. A similar scenario also occurs when the company intends to raise fund from bond through a financial institution. Unlike in Europe where PPP/PFI flourished because the financial system, there is more open in providing debt to the company to participate in PFI project. According to Edwards (2005), George (2003), and Dixon et al., (2003), the companies will get financing from commercial banks and other financial institutions to ensure that the project PFI can perform adequately and efficiently.

#### *4.3. Lacking of output specification*

Lacking of output specifications has led to delay in completion of the project. According to the NAO (2003) and Chee (2007), PFI contracts must state the output of specification or the complete schedule requirements to ensure projects meet time, quality and cost targets. Almost all the interview respondents and case studies have emphasized that the output specification is an important determinant of project space consumption, and therefore, it must be provided with care. But in reality, the output specification provided is vague and loose so troublesome the concession. This situation has contributed to the delay in completion of PFI projects because of the long negotiation process. The situation is different with the actual concept of PFI where according to KPMG (2003), the government should ensure and provide the required output specification in PFI projects.

#### *4.4. Obscurity*

The result show that the implementation of PFI projects in Malaysia was not transparent, especially when involving the tender process. Findings from the case studies showed that the PFI projects implementation is not transparent in the tendering process for using bid through direct negotiations and not open to all contractors. This finding is contrary to the Deloitte (2006), Louie (2009) and Rumaizah et. al., (2013), where they emphasize that PFI projects should be carried out in a clear and transparent manner to ensure that the projects can implement effectively. From the interview respondents, PFI will not be an open competition for a current project. It will be like another concession project. Usually, the construction companies will prepare a proposal for the government. If the government is interested, the negotiation stage will take place. He believed that transparency is hard to achieve because there were involve many sensitive issues such as the interest of individual parties, political agenda, and others. This phenomenon is in conflict with HM Treasury (1999) and Cartlidge (2006), which recognized that an efficient tender process for PFI projects is to promote competition in the open bidding. According to Datuk Hashim Nordin, Director of Monitoring and Coordination of the National Key Result Areas (2010), Malaysia has its approach in considering all aspects related to the implementation of a tender to ensure it provided in a fair and transparent

manner. Therefore, this clearly shows that transparency is necessary to apply as the key features in the implementation of PFI projects in Malaysia.

#### *4.5. Allocation of risks*

The findings showed that there was risk sharing in PFI mode 3, whereas for PFI projects Mode 1 and Mode 2, the risk borne by the government. Ineffective distribution of risk is one of the factors contributing to the problem delay. Many risks are bare by the government when compared to the private sector. It is due to the lack of understanding in respect of the implementation of the PFI procurement among government officials and the contractors involved. It is also attributable to the lack of guidelines and framework structure resulting in the implementation of PFI projects still using the traditional approach. This phenomenon is different from other countries such as from the UK and Australia (Akintoye et al., 2003 and Li et al., 2005), where the government promotes PFI with the aim to establish priorities on how the risk of PFI projects is between the public and the private sector.

#### *4.6. Political Interference*

The issue of political interference also is a contributing factor to the administrative inefficiency. All respondents from the interviews and case studies agree that there is an element of political interference in the implementation of PFI projects in Malaysia. This finding supports studies conducted by Grimsey and Graham (1997) and Ohama (2008) in which they emphasized that the implementation of PFI projects is complicated when it comes to political interference that requires lengthy debate. Therefore, this phenomenon will pressure on the industry players, especially the contractors, as they have to go through such a difficult stages for approval of proposals, financing, negotiation with the UKAS and users.

#### *4.7. Lack of clear set of guideline and framework*

The findings consistently showed that all the constraints that occur in the pre-construction stage are due to the lack of structure framework and clear guidelines for the implementation of the PFI. The results of case studies have also proven that PFI projects Mode 1, Mode 2 and Mode 3 delayed due to the lack of guidelines and framework that can be followed and evaluated. This medium disrupted the smooth implementation of the PFI project as a whole. The finding showed, when there is no clear guideline, it will lead to its implementation would be problematic. Allocation of risks cannot see clearly, who is ultimately responsible. This phenomenon is not consistent with Chan et al. (2008), where he states that the complete framework will contribute to the effective implementation of the PFI. Respondents also suggest that a clear framework structure of how the implementation of PFI projects to encourage investment from the private sector should hold. It includes the rules for interpreting the PFI, to authorize the implementation process and provide the highest level to promote the implementation of the PFI. According to United Nations Economic Commission for Europe (2007) and Ahmad Zamri (2010), states that the government should provide clear guidelines to ensure the implementation of PFI projects can use as a reference to all industry players, especially contractors.

#### *4.8. Inadequate adoption of maintenance element*

One of the issues that need attraction in the implementation of PFI projects Mode 1, Mode 2 and Mode 3 is maintenance culture approach for the safety and convenience of the public. According to Abdullah (2008), Malaysia is famous for its ability to provide world-class infrastructure but not regarding maintenance. Maintenance and service culture was not practiced in Malaysia. According to Zuhairi (2008), for the implementation of PFI projects, 75% concentration should be given to the maintenance and 25% for operational aspects. From the findings showed that it did not use this approach because of the project is focused on the construction and operation only while the maintenance will be under the obligation of liability any ministry except PFI project mode 3. This finding is contrary to Dixon et. al., (2003), in which it emphasized the culture of maintenance are key features in the PFI procurement

where private parties are responsible for ensuring that the assets maintained throughout the concession period have determined. Thus, indirectly can be seen that there is an improvement in the evolution of the implementation of the PFI in Malaysia where a culture of maintenance was first mooted in public buildings and it is the responsibility of the contractor for the duration of the concession period that has set.

## 5. Conclusions

The objective of this paper to discuss the key issues and challenges of PFI implementation in Malaysia compared to other countries have achieved. Results from the content analysis show that there are differences between Malaysia and other countries regarding PFI implementation. Maintenance is not in the concession agreement and will be under the obligation of liability of any ministry except PFI projects Mode 3, the output specifications, and the needs statement is not clear and tender process conducted by negotiation. However, there are also similarities in the purposes of implementation of PFI projects in Malaysia and other countries. The government does not want to carry a heavy burden in early stages; the government wishes to encourage private sector involvement and investment in public projects, and the government wishes to expand the economy. The advantages of PFI can be fully gained if there is a close collaboration between the government and the private sector. Even there are several issues of PFI are not finalized yet due to its newly introduced concept, the key issues and challenges are addressed through investigation of several aspects. It is believed that the PFI will be a panacea to the shortage of government funds and poor maintenance culture if the PFI executed in more efficient and transparent manner.

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