

**Public Private Partnership in the Health Sector  
Practical Issues for Consideration**

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# Contents

- Acknowledgement ..... i
- Acronyms ..... ii
- Introduction..... 1
- Key issues to consider in PPP projects..... 1
  - Legal and regulatory framework ..... 1
  - Economic viability ..... 2
  - Trust and commitment ..... 3
  - Contracting ..... 4
  - Monitoring and supervision..... 5
- Contracting and contract management in PPP projects ..... 5
  - The PPP contract: the main operational management tool ..... 6
    - Focusing on the operational management provisions of the contract* ..... 6
    - A sound payment mechanism* ..... 7
    - Proper use of deductions and penalties: demanding but fair*..... 7
    - Retaining some flexibility*..... 8
  - Adopting a User-Friendly Contract Management Manual ..... 8
    - A multipurpose document*..... 9
    - Who should draft it and when* ..... 9
  - Information and data management tools ..... 10
    - Defining the information scope and transmission process* ..... 10
    - Using IT solutions to obtain reliable information* ..... 11
- Conclusion ..... 11
- References ..... 13

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## Acronyms

IFC	International Finance Corporation
IT	Information Technology
NKTI	National Kidney Transplant Institute
OECD	Organisation for Economic Co-operation and Development
PHRD	Japan Policy and Human Resources Development
PPP	Public Private Partnership
PPPC	Public-Private Partnership Center
PSC	Public Sector Comparator
QMMH	Queen Mamohato Memorial Hospital

## Introduction

In 2012, the government of the Kyrgyz Republic embarked on an ambitious public private partnership (PPP) program across a range of public infrastructure sectors. Driven by the constraints in the public sector financing, PPP is seen as a central element of the government's reform agenda by increasing private sector investment in public infrastructure. Not only was PPP seen as beneficial in reducing the need for public borrowings, it was also expected to provide better quality services and bring about other benefits, such as transferring the risks that may be more efficiently managed by the private sector.

The first PPP project in the health sector was launched in early 2016. The Hemodialysis Project aims to provide quality services and access to hemodialysis treatment for patients with kidney failure. The initial project brief was prepared by the Ministry of Health with support from the Investment Promotion Agency and the Ministry of Economy. International Finance Corporation (IFC) was assigned as the Lead Transaction Advisor, supported by technical and legal consultants Rebel Group (Netherlands) and Kalikova & associates (Kyrgyz Republic) with financial assistance from the German Development Bank.

Given the novelty of PPP as a financing and service delivery mechanism, it is important that public sector authority in charge is aware of the pros and cons of PPP and builds up its capacity to manage PPP projects. The purpose of this note is to provide a framework to advance such understanding. The first section of the note lays out essential elements that a public sector authority should consider before embarking on a PPP projects. The second section focuses specifically on issues in contracting and contract management, which are the most important factors for a successful completion of PPP projects but are often not adequately considered upfront. The note aims to provide practical knowledge and it complements various extensive review of PPP.<sup>1</sup> The note serves as a background material for a Contract Management Workshop which was organized by the Ministry of Health in May 2018 with a joint support from the World Bank and IFC.

## Key issues to consider in PPP projects

There are several essential elements that a public sector authority needs to consider when PPP projects are created and implemented. These include: (1) legal and regulatory framework, (2) economic viability, (3) trust and commitment, (4) contracting issues, and (5) monitoring and supervision.

### Legal and regulatory framework

When starting a PPP project in health, public and private parties have to observe laws and regulations, including public contract and procurement laws, laws and regulations in the health sector, and laws affecting contracts and operation of private firms, licensing requirements, tax rules, employment, insurance, etc. If a government is to promote PPP, it may be essential to amend some of the laws and regulations to facilitate the participation of private partners in providing public services. It may be straightforward if there are laws that specifically govern PPP, but the government needs to make sure that the PPP laws do not contradict with other laws and regulations that govern activities of PPP projects in health.

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<sup>1</sup> Some examples include Abuzaineh et al. (2018), The World Bank Group (2013), Nikolic and Maikisch (2006)

A clear regulatory framework will generate enabling environment for necessary institutional arrangements for PPP. It is important to set up a dedicated unit for PPP in the central government as well as in a line ministry responsible for health services. The unit should have experts on laws and regulations and who can provide advises to the line ministries.

In the Philippines, Public-Private Partnership Center (PPPC) was established in 2010 to facilitate the implementation of the country's PPP programs and projects. The PPPC serves as the central coordinating and monitoring agency for all PPP projects in the Philippines and provides technical assistance to government agencies to help develop the PPP projects. In 2017, with the support from PPPC, Department of Health established the unit dedicated to PPP. The PPP Unit within the Department of Health coordinates the evaluation and implementation of PPP projects in health (both solicited and unsolicited projects). The Unit currently has 8 staff-members: a program manager, a senior health program officer, a medical officer, technical officers, an administrative staff, an assistant for administration, a lawyer (part-time). According to the PPPC, it would be ideal to add an expert on public relations into the team because informing the public of the projects effectively is crucial for its successful implementation.

(The information was collected from interviews conducted in September 2017 by Tsutomu Kitajima).

### **Economic viability**

A PPP project may be considered of value for money if it can reduce the life-cycle cost of the project, improve risk sharing, implement it early, improve quality of services, and produce incremental revenue (European Commission, 2003). Implementing projects also entails a risk, a probability of deviating real outcome from the expected outcome. Risk can be divided into legal or political risk and commercial risk. The former is concerned with the regulatory framework, public policy, and nationalization. The latter includes risks related to procurement of capital and labor for constructing facilities, producing and providing goods and services, changes in preferences of consumers, and an introduction of substitutional or complementary products or services in a market. Private organizations are usually capable of managing commercial risks more efficiently than public sector. Therefore, they are expected to complete the project with life cycle cost lower than what government agencies would have to bear if they do it by themselves (OECD, 2008).

Public sector comparator (PSC) is a criterion to measure whether a PPP project would be of value for money. PSC is the estimated net present value of the project if the public sector conducts the entire project. Thus, a PPP project is considered of value for money if the estimated net present value of the project is lower than the PSC for the project (Siroky, J., 2014). However, one should note that not all expected benefits can, or can easily, be quantified on monetary terms. For example, improved patient experience is difficult to value. Therefore, analyses of value for money need to be cognizant of the applicability of such qualitative attributes.

Although private sector typically wins over the public sector on the ground of efficiency, it is not good at delivering services equitably (Kramer et al., 2017). Thus, it is also important to consider carefully whether a value for money PPP project is the best option if equity is given higher priority in the expected outcome of the project.

In most PPP projects, the private partner bears a responsibility of securing capital for the initial investment. That amount is not going to appear on the balance sheet of the government. However, the government is going to purchase services from the private partner for a period specified in the contract of the project. Thus, it is essential to conduct a fiscal analysis to assess whether the government can continue to afford it in the long run. Typically, governments may find themselves tempted to embark on a hospital PPP model because it relieves the government from a significant initial fiscal burden. However, it is advisable that the impact on health system should be carefully assessed before initiating a hospital PPP project. Similarly, one should also note that the financial sustainability and bankability for the private partner are equally important for the PPP to be successful.

#### Queen Mamohato Memorial Hospital (QMMH), Kingdom of Lesotho

This PPP project in Lesotho is about designing, building, partially financing, and operating a national referral hospital and gateway clinic adjacent to the hospital, and refurbishing and operating three filter clinics in Maseru, the capital of Lesotho. As the result of a competitive bidding, Tespong, a consortium of private organizations established for this project, was awarded the project. The contract period is from 2008 to 2026. The Government of Lesotho pays Tespong the unitary payment of US\$22 million on the condition that QMMH and its filter clinics provide 20,000 inpatients and 310,000 outpatients annually. If the number exceeds the targets, Tespong is entitled to receive an incremental payment per patient from the government according to the negotiated rates (Siroky, J., 2014). The filter clinic opened in May 2010 and QMMH in October 2011. The project has an independent monitor appointed by the government and private operator, who performs a quarterly audit of the contractual performance indicators.

At the time of project preparation, affordability of the project was assessed using the operational cost of the referral hospital that the project was going to replace. Several private parties confirmed that they could provide the type of services for the number of patients specified in the request for proposal within the estimated amount (Lee, H., 2013). However, after QMMH and its clinics started providing services, the amount of payment to the private party increased by nearly 2.5 times compared to what was initially estimated. One of the reasons for this cost escalation was because the number of patients treated at QMMH and its clinics exceeded the estimation, partly due to the weak primary and secondary medical system which inevitably fed the patients into QMMH and its clinics. Thus, public expectation and capacity of the system as a whole was not adequately taken into account. In fact, it might have been better if primary and secondary care system was strengthened before replacing the tertiary hospital (Webster, P., 2015).

### **Trust and commitment**

It is indispensable for a government agency to nurture trust with private parties to successfully implement a PPP project. Therefore, it is vital to inform the private parties about benefits and risks, and to what extent the private parties are expected to shoulder risks in a potential PPP project (Siroky, J., 2014). At the same time, health and finance ministries need to express their commitment to the successful implementation of the project. Engaging the private sector in the initial stage of the project development may be useful to create a relationship with trust and to draw their commitment to the project (Wong et al., 2015).

The ultimate goal of the private sector is to make profits, which may not go well with the value of government agencies. Thus, there has been a concern among the personnel in the public sector toward providing public health services by PPP (Itika, Mashinado, and Kessy, 2011; Sadghi et al., 2016; Fanstino and O'Farrell, 2011). Where there is a distrust, it is difficult to have a good partnership. It is therefore crucial for a government agency to dispel such suspicion and share common goals of PPP through communication among stakeholders.

At the stage of developing a project proposal, the information about the project is shared among the stakeholders to make the proposal workable for both public and private parties. When it comes to deciding who is going to conduct the project, transparency is essential. A competitive bidding is a recommended procedure for selecting private parties for a project.

Engaging private parties before the tender was important to develop a good relationship between public and private parties. In Hong Kong, one of the reasons why PPP projects on hemodialysis and general outpatient clinic were implemented successfully was because they could receive a high-level commitment from private partners. According to the key informant of the project, the government agency actively communicated with private parties about goals and objectives, risk and benefit of the project from the early stage of project development. This nurtured trust among the parties and drew commitment to complete the project (Wong et al., 2015).

## **Contracting**

Contracting is the most critical and challenging part of implementing PPP projects. Contract in PPP projects is usually confidential. PPP projects in the health sector are also diverse. Thus, it is difficult to generalize what should be there in the contract. Nikolic and Maikisch (2006) recommended that a contract should have the following items: definition of project stages, schedule, a specification of services, compensation, financing, adjustment mechanisms, statues for regular information and audits, organization, intellectual property rights, duration and termination, exit strategies, applicable law and claims (Nikolic and Maikisch, 2006).

Most PPP project in health are relatively short-termed, but hospital PPP projects usually last for nearly 20 years. In such cases, it is inevitable to modify the contract before it expires because health care needs of the target population change according to changes in population structure, economic growth, and advancement of medical technologies. A government agency must carefully monitor changes in situations and anticipate how it should address them as a part of contract management (Monteiro, 2011).

Making and managing a contract requires expertise in economic analysis as well as engineering aspects of the project, and coordination among and negotiations with government agencies and private partners. It is therefore important to set up a dedicated unit for PPP in the central government as well as in a line ministry responsible for health services. The unit should have experts on laws and regulations. The unit is expected to accumulate the knowledge and experiences of developing and conducting PPP projects so that it can provide nuts and bolts of creating PPP projects with the potential partners. In the Philippines, Public-Private Partnership Center was established in 2010 to facilitate the implementation of the country's PPP programs and projects (Public Private Partnership Center, 2018). The Center serves as the central coordinating and monitor agency for all PPP projects in the Philippines and provides technical assistance to government agencies for developing PPP projects.

## Monitoring and supervision

Upon starting a PPP project, the government agency has to monitor and supervise whether the private partner is performing according to the contract. What will be monitored depends on the nature of each project. In the United Kingdom, key performance indicators (KPIs) were identified in areas of efficiency, outcome, service quality, fiscal performance, and service output in each PPP project. These KPIs were measured at baseline and monitored throughout the project (OECD, 2008).

It is essential to specify what indicators are measured and at which frequency. It is also necessary to specify the penalties if such indicators do not reach the target. If the private partner fails to meet the target of some of the indicators, the government agency should find out the reasons and help address the problems if necessary (Chen et al., 2016).

Monitoring and supervision are complex tasks and needs to be conducted routinely. Thus, it is advisable to set up a dedicated unit for this task during the project period (Nikolic and Maikisch, 2006). Using accreditation from an organization outside the project may be an option for monitoring quality of services if such task is beyond the capacity of the public authority. Furthermore, setting up a Liaison Committee, composed of both parties, meetings regularly with specific obligations, is a good way to foster communication and avoid problem escalation.

### Hemodialysis Center at National Kidney Transplant Institute, Philippines

National Kidney Transplant Institute (NKTl), a public autonomous hospital, established a hemodialysis center using a scheme of Build-Operate-Transfer. After a competitive tender process, Fresenius Medical Care was awarded the concession of the hemodialysis center. The first contract was awarded for 2003-2008 and was extended for another five years. NKTl monitored the quality of the project performance. Key performance indicators of the dialysis center reflect the goals of: (1) highest level of hemodialysis service in the Philippines, (2) increased number of treatments in both in-house and out-patients (24/7), (3) new machines and equipment, (4) round-the-clock maintenance crew to ensure quality of the machines, (5) availability of medical doctors and other specialized medical professional/staffing which guarantees the patients ultimate daily care, (6) no price increase for the treatment. The head nurse at the dialysis center who are employees of NKTl monitored the clinical indicators.

Source: Economic Commission for Europe (2016)

## Contracting and contract management in PPP projects

In the past years, many countries have undertaken systems reforms to adapt to the new concept of PPP. The initial effort to change legislation is followed by drafting additional regulations, setting up institutions, and developing training programs for government officials, the private sector and civil society. While this wave of reforms has created the legal and institutional frameworks for PPP, there is now a need to focus on the operational management of PPPs to transform the culture of compliance into one of performance excellence and achievement of results.

Experience shows that the public entities involved in PPP projects tend to focus on procurement issues leading to contract signature. Authorities are inclined to assume that the PPP contract will take care of itself once it has been signed and/or once the project has been completed. To ensure that PPP delivers its expected benefits over the long run, the authorities “deal” focus need to shift to a long-term “management” culture.

Common to all PPP models is a carefully-structured contract that should ensure that the government does not give up its responsibility for public service, but rather assumes enhanced and transparent responsibility. The key features of a good PPP contract include:

- (a) *Substantial risk transfer to the private sector.* The most important feature of PPP arrangements is the identification, quantification and allocation of risks to the parties best able to manage them.
- (b) *Output and quality of service specification.* The focus of PPPs is on the specification and delivery of services associated with the procured assets rather than on the underlying assets, allowing the private sector to decide how best to provide the services.
- (c) *Performance-related rewards.* Payment should be related to performance standards being met, with typically no payment during the build phase.
- (d) *Entire whole-life performance.* Integration of capital construction with ongoing operation and maintenance services, together with continuous monitoring over the life time of the contract should ensure efficiencies from long-term private asset management.

Guidance on the matter will hopefully raise awareness and reinforce the ability of Authorities to (i) plan their own operational management strategy and (ii) execute it without missing out any important steps that they will not be able to make up for.

### **The PPP contract: the main operational management tool**

The PPP contract sets out the basic rights and obligations of the parties during the construction and operating phase of the project. As a result, it should be the main operational management tool for the public authority.

#### ***Focusing on the operational management provisions of the contract***

When drafting the proposed contract and negotiating it with the bidders, the public authority should pay special attention to the operational management provisions to ensure that they are coherent, precise and comprehensive. The main provisions are typically as follows:

- The planning, execution and monitoring of design and construction;
- Requirements regarding the appointment of key staff;
- The performance objectives and how to measure them, including clear output indicators;
- The planning, execution and monitoring of maintenance;

- The payment mechanism, including performance incentives and continuous improvement measures;
- The management of refinancing opportunities, including the profit-sharing mechanism;
- Information provision requirements;
- Reporting made to the Authority;
- The management of minor and major changes;
- Expiry or termination of the contract; and
- The prevention and resolution of disputes.

### ***A sound payment mechanism***

A sound payment mechanism is, together with the risk allocation, at the heart of the PPP contract. Because contract performance mainly concerns the operational aspects, it is important to ensure that the mechanism specified in the contract can be applied in practice for effective, trouble-free operational management. Again, this issue should be addressed prior to contract signature, ideally during the procurement phase.

The payment mechanism should incentivize the private partner to deliver the right level of performance, without unnecessary and costly over-performance, and penalize it if it fails to do so.

In “Authority-pays” contracts, the most common arrangement is a regular payment which is conditional upon the availability of the project facilities or services, with deductions being made for poor performance/unavailability. Designing the payment mechanism is a very delicate exercise that rely on: (i) performance indicators; (ii) the initial targets for those indicators and regular measurement during the operational phase; and (iii) the link between those indicators and the appropriate payment deductions. To be efficient, the payment mechanism should:

- be built on the performance requirements of each specific service, translated into a reasonable number of measurable indicators;
- be based on clear and pre-defined performance measurement methods that are not subject to subjectivity or bargaining;
- include reasonably ambitious performance targets, possibly dynamic, to ensure that incentives are maintained throughout the contract;
- be as simple as possible; and
- contain deductions and penalties that matches the level of underperformance (use of periodic and overall thresholds, and an escalator mechanism to penalize repeated underperformance).

### ***Proper use of deductions and penalties: demanding but fair***

Provided that the payment mechanism has been adequately designed, the Authority should apply it in full to provide the private partner with a real incentive to perform. The value for money of the service provided very much depends on the ability of the Authority to maintain fair but effective pressure on the

private partner. The Authority should explain that deductions and/or penalties are meant to be a way to ensure the proper delivery of the services.

That said, the Authority may in certain circumstances decide not to enforce its contractual right to impose a deduction or a penalty if it considers that there is an overriding interest for it not to do so. This applies in particular where, despite a clearly worded contract, it is impossible to establish precisely what the private partner should be held liable for.

### ***Retaining some flexibility***

Because PPPs involve long-term agreements dealing with generally complex projects, it is impossible to foresee all the possible future events that may arise during the life of the contract. Although it is important to seek to identify, assess and allocate risks in a way which covers most future scenarios, there is always temptation to draw up a contract that is excessively complex and will in practice be and costly to manage.

To ensure that a contract is easily manageable throughout its life and will subsequently deliver value for money, some flexibility should be introduced.

Here, however, there are a few things to avoid, such as:

- if the contract provisions are too flexible, risks that need to be transferred to the private partner may in fact not be fully transferred or may not be transferred in a sufficient manner; and
- if, on the other hand, the provisions are too rigid, the Authority will be penalized should it face the opportunity, during the life of the contract, to obtain better value for money by making changes to the services provided.

Ways of ensuring that the contract retains a certain degree of flexibility include:

- During the procurement phase, gather details on the cost structure and the economics of the project. In the event of future negotiations on, for example, adjusting the scope of the services, this will provide a solid basis for discussion;
- Similarly, again during the procurement phase, ask the private partner to commit to unit prices for marginal items of works or services;
- Insert provisions on sharing profits/savings in the contract, not only where they depend on the efficiency of the private partner (e.g. refinancing opportunity, change in the law or technological improvement offering possible savings); and
- Finally, it should be made possible, where major changes in requirements are anticipated, but cannot be determined in advance, to reduce the scope of the contract or, alternatively, opt for partial early termination for part of the services.

### **Adopting a User-Friendly Contract Management Manual**

Adopting a contract management manual is recognized as good practice. The contract management manual provides a road map on how to manage the contract efficiently for all those at the Authority who will be involved in that process, either directly or indirectly. Clearly, the manual should not substitute the contract which will always remain the “reference” document.

### ***A multipurpose document***

The contract management manual should explain clearly, in a user friendly style, what is expected of the Authority in concrete terms in order to (i) fulfil its practical obligations to the private partner (i.e. “what do I have to do?”) and (ii) assume its own duties in terms of follow-up and monitoring (i.e. “what do I have to check?”).

The manual provides the Authority with a means of planning and setting out its own organizational arrangements. These matters are typically not covered in the PPP contract itself as the Authority is often reluctant to share with the private partner information regarding its own arrangements or because it may be inappropriate to set out in a contractual agreement provisions that might be subject to frequent unilateral changes. This is typically the case of internal procedures involving different departments within the Authority’s administration (e.g. operational management team and accounts department for the payment procedure). With respect to projects that involve numerous public stakeholders (e.g. hospitals), the scope of the manual may be broadened to deal with the interaction amongst the key public stakeholders public players.

The manual provides an opportunity to set out the operational management strategy and, have it approved at the appropriate level of the decision-making chain. In particular, such a strategy will aim to address the specific risks of the project that the Authority needs to manage. For this reason, when drafting the document, the Authority will need to pay particular attention to highlighting the main risks of the project and ensure that the will provide all the necessary tools and processes to mitigate those risks.

Finally, the manual will serve as a reference document throughout the life of the contract, facilitating any handover that may be required between different members of the operational management team.

### ***Who should draft it and when***

It is often better to ask those who will be in charge of operational management to draft the manual, in collaboration with the procurement team and legal advisers. This approach has three advantages:

- It ensures that the manual will be drafted in everyday language and be accessible to all those who will subsequently be involved in operational management;
- It encourages information sharing between those involved in the procurement and post contract signature phases; and
- It obliges operational staff to become familiar with the PPP contract and its appendices and acquire both an overview and a detailed understanding of the contents.

Some parts of the manual, especially those dealing with the interface between the Authority and the private partner (e.g. data collection, performance measurement, billing validation process) may usefully be shared with the private partner to obtain feedback and ensure that it too will develop a similarly well-coordinated organizational set-up.

Initially produced prior to contract signing, the manual must be regularly updated throughout the life time of the project to take account of changes to the contract (mainly resulting from amendments) and/or in its external environment (e.g. changes in the law, changes in the way in which the Authority is organized). The first version of the manual can focus mainly on design and construction matters, while those relating

to the operating period can be developed during the project's construction phase. Guidance on managing periodic reviews and the end of the contract can be developed as progress is made.

### **Information and data management tools**

Experience shows that gathering adequate information is fundamental to the operational management process.

#### ***Defining the information scope and transmission process***

The Authority should impose on the private partner a contractual duty to provide regular reports on how it is performing. The information will typically include:

- Technical, such as performance indicators or the maintenance tasks that have been carried out during a given period;
- Financial, such as the financial statements of the private partner; and
- Legal items, such as a major change in a sub-contract.

The private partner will sometimes be reluctant to share information with the Authority. It is important for the parties to strike a suitable balance.

The Authority should:

- Limits its requirements to what is strictly necessary to fulfil its responsibilities without interfering in the private partner's management; and
- Be fully able to monitor the performance of the services and deal with difficulties that may arise (e.g. force majeure, default by the private partner).

During the contract drafting process, the Authority should be clear and precise regarding the level of detail, format and deadlines of the data to be produced by the private partner. Information requirements differ between construction period and service period. However, for both periods, the type of information needed from the private partner should be carefully considered to avoid:

- requiring too much information, which would be costly to produce and analyze; and
- requiring too little information, which would limit the Authority's ability to perform its duties.
- The "information package" provided for in the PPP contract could include:
  - Monthly or quarterly dashboards, designed to offer, at a glance, an overview of contract performance during the period in question;
  - An annual report, providing a comprehensive view of all the relevant technical, financial and legal data regarding the performance of the contract during the year that has just ended; and
  - Real-time data and summary reports on service performance levels via an IT solution

Penalties may be introduced to incentivize the private partner to comply with its commitments both in terms of timing and the quality of information delivered.

### ***Using IT solutions to obtain reliable information***

Performance must be closely monitored by the Authority so as to ensure a proper and constant engagement of the private partner. Most private companies involved in PPPs use IT solutions to manage their activities. They are used in-house, for example, to monitor a range of technical indicators, plan future operations, assign tasks within the operational teams and keep a record of the works carried out. They are sometimes linked to accounting software to facilitate integrated business unit management.

In this context, it is good practice for the Authority to:

- Stress in the tender documents that the Authority expects to have transparent access to these tools throughout the life of the contract;
- request the private partner to design appropriate IT interfaces.

Clearly, the Authority will need to ensure that there is full consistency between the contractual performance indicator methods it will impose and the IT interfaces that will be adopted. The aim is to ensure that performance can be measured and monitored using the IT tools and that these IT tools generate reliable and accurate data on a regular basis.

Apart from being useful for monitoring the day-to-day performance, an IT platform can also be employed to:

- Manage the help desk that will enable the private partner to receive queries from the Authority and end-users;
- Manage payments and calculate the deductions and/or penalties to be applied; and
- Store and share documents between parties, such as updated contractual documentation and annual reports.

Finally, it is good practice for the operational management team to keep a record of all key documents received and sent in a dedicated database using an electronic document management system.

### **Conclusion**

This paper provides a framework to help think through key issues in PPP with a particular application to the health sector. It puts a strong emphasis on the operation aspects, post-contract period, of the PPP projects. The paper serves as a background for a workshop on PPP in the Kyrgyz Republic jointly supported by the World Bank and IFC. Taken together, these activities aim to help the Ministry of Health of the Kyrgyz Republic to successfully manage the first PPP project in the country, the hemodialysis project, and make informed decisions regarding future PPP projects.

Public Private Partnership is not a panacea in development, yet it is promised to help address a number of constraints faced by the public sector. As the country economy continues to develop and the role of traditional donors in the health sector dwindles down, the role of the private sector will become increasingly important. It is therefore important for the public sector authorities to be prepared and become a proactive player in this new stage of development.



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