BALANCING QUALITY CUSTOMER SERVICE WITH FINANCIAL RETURNS IN PRIVATIZED PARK SERVICES

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Abstract: The privatization of public facilities continues to be an issue that impacts the bottom line of many public agencies. Choosing a concessionaire or contractor involves much more that selecting the highest bidder. Examining all the variables is a necessity.

The trend in park management today is toward "privatization" of park operations. The term "privatization," in this paper means contracting with private businesses for the operation of specific park functions which have previously been, or could potentially be, operated by government employees. The sources of funds to pay the private business can come either from tax dollars or from fees for services the contractor collects from park customers. In some cases a single contract can involve both sources of funds.

In the case of the funds coming from fees for services from customers of the park, the private business contractor is usually called a "concessionaire." The concessionaire typically operates a physical plant, provided by the government entity, or provides services on site. The goal is to allow private business to provide the desired services in the government setting as a way of cutting costs to the taxpayers and improving levels of service to customers. The concessionaire may pay a flat fee to lease the government facilities or he may pay a percentage of the gross sales generated by the facility for the contract rights to them. In some cases such gross sales may not generate enough funding to cover the concessionaire's costs an operating subsidy or an additional payment to the concessionaire may be called for from tax dollars.

In the case of funds coming from tax dollars, the private business contractor is usually called just that - a "contractor." The contractor typically provides services on the site or in some cases also operates a physical plant. The goal is the same, to allow private business to provide the desired services in the government setting as a way of cutting costs to the taxpayers or of improving levels of service to customers. The contractor receives a fee under the terms of the contract for the services rendered. Any fees collected by contractors usually are fully turned over to the government entity.

As is apparent from the above the line between "concessionaires" and "contractors" gets very blurred when one begins to get creative with privatization of park facilities and functions. Many different types of leases, contracts, and other legal agreements can be used quite successfully in any of these instances. They are indeed so close that, in the author's opinion, you cannot discuss concessionaires without referencing contractors and vice-versa.

This paper is broken down into three parts:

1. A discussion of identifying and structuring the "privatization" opportunity.
2. A look at various ways of selecting the best private business operator as a concessionaire or contractor.
3. The concerns and problems with successfully managing privatized contracts once they are in place.

1. IDENTIFYING AND STRUCTURING THE PRIVATIZATION OPPORTUNITY VS. LEAVING IN-HOUSE AS A SELF OPERATION

A. Contracting opportunities which are directly paid for with tax funds most usually present themselves in the form of a function that is now performed by government employees, which could potentially be performed by private business. Such things as garbage collection in a park, guestroom housekeeping, utilities operation, the hiring of trade crafts such as electrical repairs, plumbing repairs, carpentry repairs, heating-ventilating-air-conditioning repairs, auto mechanical and body work, and the like readily lend themselves to privatization.

The concerns in structuring such opportunities lies in ensuring that logistical support, geographic distances, economies of scale, and needed specialized training, among others, are favorable to a privatization effort. The basis for the trend towards "internal competition," in which the internal operation bids competitively with external private businesses, lies in these major structural areas. In essence the structure of a given park opportunity may be such that the internal bid for a self operation by the government agency can perform these activities more cost effectively and with higher levels of customer satisfaction than an external private business.

Logistical support comes in many forms. Contract supervision is one area that deserves a careful look. If the task you are asking a contractor to perform is so specialized that you have to have one or more supervisors present at all times, it may be more cost effective to retain it as a government function. Support services a contractor may require in the way of utilities, inside facilities, access, and work areas may impose an unacceptable cost burden upon your existing staff which fails to get reflected in the contract terms and costs the taxpayer more, not less.

Geographic distances from a private business may be such that it cannot operate at acceptable costs in your park area. Too often contract terms fail to account for the distance factor, especially when the contract specifies some type of contractor supervision of his/her own employees. The geographic distance factor too often results in unsupervised contract employees who wind up not accountable for the work being performed and very poor customer service.

Economies of scale are related to geographic distances. They are considerations for looking internally for competition for a privatization opportunity. Economies of scale are particularly applicable in situations which are weather dependent, consist of less than eight hours of work per day, or have parallels in a park situation which cannot be successfully bid out. If the park has staffing that can be easily moved to other productive duties during inclement weather or when tasks of less than eight hours are performed, then internal competition should be considered. Contractors have a hard time responding in a cost effective manner to weather changes or work load changes over the distances from outside the park. In too many instances they simply don't respond and customer service suffers.

Specialized training is another area to be careful of. Trail maintenance is an example. There are very few qualified outside businesses which possess the necessary level of expertise at the supervisory level to run a successful trail maintenance program. This is an area that is very hard to screen for when bidding. It doesn't make good sense to trade highly trained public employees for untrained private employees who produce an inferior product.

Cherry picking is the structuring of privatized bids to include only the most "profitable" or most cost effective functions in a particular bid. This leaves the park with the problem of operating the "unprofitable" or least cost effective functions at an even greater financial disadvantage to the taxpayer than before privatization.

An example of this would be to contract out the large, major, easiest accessible grass areas for mowing while leaving the small, minor, remote areas for the park staff. Certainly a contractor can do these "cherries" more cost effectively than the park because that is all the contractor has to do. In the end this costs the taxpayers money because now you have two mowing operations and the government one is very cost ineffective.

B. Concession opportunities include everything we have covered to this point plus the need to structure the opportunity so that the prospective concessionaire can make a reasonable profit. The greatest single failing in concession contracts is to load it up with so many terms that the operator in the end cannot make a reasonable profit. Regrettably many of the concessionaires who bid on park concession type contracts are not sophisticated enough to recognize situations in which they cannot reasonably make a profit. Too many times we have seen businesses go down the tubes because there is simply no way that they can make a profit. When this happens they take the park clientele with them on a very ugly ride to default.

Key to this point is a conservatively accurate statement of the prospective cash flow a concessionaire can reasonably expect and a sound statement of the risks he/she faces from weather dependent outdoor recreational opportunities. In Ohio we have discontinued a number of concession contracts which simply did not generate a cash flow sufficient for anyone to come in from the outside and make any kind of profit. In these instances we have either modified or discontinued the service or elected to self operate it at a loss subsidized with tax dollars. The penalties to the customers in poor service from staggering from one unsatisfactory concession operation to the next were simply unacceptable.

Bundling unlike services is another area to be careful of. Parks tend to contract things by geographic area. That is to get a concessionaire to operate everything at one given location or series of locations. Food service linked with other services is an example of this concern. The food service business is an extremely competitive and low margin business. The people who know what they are doing, and can make a profit, often specialize in this area. Too often we will structure contracts for marina services, beach services, or other outdoor recreational services in which the food service aspect is a secondary aspect of the contract. Once let we wonder why everyone complains about the food when we in fact have a concessionaire who has little expertise in that area. It is better to separate specialized services and bid them out to specialists, rather than bundle them to a generalist, if at all possible.

The exception to this concern occurs when you have very large facilities which generate very large cash flows that can attract very large firms who have expertise in a number of related areas.

2. SELECTING THE BEST PRIVATE BUSINESS OPERATOR:

A. Contractors are usually selected by open market bids which typically go to the lowest bidder. Most states and other government entities have very large bodies of rules and laws on how these contractors are to be selected. Nothing said here is meant to be taken to contravene any existing rules or laws we all work under. That said, however, there are many ways one can work within existing rules and laws to select good operators. These strategies depend on: a carefully written bid package focused on the exact services desired while screening out potentially unqualified bidders and a bid selection process that is capable of screening out unresponsive bids and unqualified bidders.

Financial terms beyond merely the lowest cost to the state need to be considered. If at all possible a flat payment for the contract should be avoided and payments tied to measure of performance should be utilized. In trash pickup contracts, payments for trash weight and volume combined by payments for each dumpster picked up are preferred over a flat service fee. In addition such a contract should include penalties, if possible, for failure to pickup on the schedule called for. Performance bonds are another strategy to employ if the market and your regulations permit.

Operating plans and schedules should be required submissions together with contingency plans for such things as weather problems and equipment failures. Many unqualified operators do not even have the skills to produce a financial plan or an operating plan at any level and will be unresponsive to bid criteria as a result.

Quality standards in order for the contractor's product to be acceptable should be spelled out together with the remedial actions required by contract if they are not. For example if trash is left scattered about a pickup point in a trash hauling contract a remedial action of requiring the contractor to clean up the area within 24 hours might be a contract requirement subject to financial penalties.

Experience and financial capability are critical terms of any contract. Government contract opportunities are constantly plagued by small operators who possess neither the experience nor financial capability to be successful. Yet the structure of the "lowest bid wins" provides an avenue for these kinds of operators to make a naive bid submission which happens to be lowest and which they cannot possibly fulfill. Government agencies are then stuck with poor performance until the bid runs out or the contractor defaults. Either case imposes hardship upon the taxpayer and the agency's customers. If at all possible in a particular agency's environment, "screen out" factors relating to experience and financial capability must be included in the contract bid specifications.

The contract term should be the very shortest the market will respond to. Government agencies too often err on the side of making contracts too long resulting in barely marginal operators that hang on and hang on to the disadvantage of the customers and agency alike.

B. Concessionaires' contracts need to incorporate everything above and then add the following items:

Financial terms should never allow concessionaires to operate on flat fees because it usually discourages any incentive to "grow the business." The exception may be in the leasing of facilities for a flat fee for operation. Such fees may provide a reasonable return on the taxpayer's investment and not discourage a quality operation. However, flat fees tend to result in benign neglect by the government agency.

Bids as a percentage of gross revenues are the most preferable way of competitively structuring concession bid opportunities. On larger offerings such a percentage may be bid by source of revenue, such as: food service, beverage service, and lodging revenues. Setting these percentages in the bid documents should be avoided. These percentages are the heart of a successful competitive process which nets the taxpayer the best return on the business opportunity.

Funds for maintaining the physical plant should be set aside as a required percentage of gross revenues in the contract bid and jointly controlled by the contractor and the government agency. Trying to write in maintenance specifications and getting the contractor to live up to them is not nearly as successful as controlling the funds expenditure and ensuring the maintenance gets done each year.

Up front investment is a problematic area. It is very attractive for a government agency to load a contract with a heavy up front contractor investment to take care of a physical plant's investment concern for which no public monies seem available. As a rule of thumb the larger the up front investment the longer the term of the contract to enable the contractor to amortize his costs. In effect you are granting a temporary possessory interest to the contractor in his capital investment onto state facilities. A small amount of up front is probably not a bad thing. It starts off the facility on an upbeat note and screens out poor operators who do have capital.

Maintenance of facilities is a critical area for contract bid specifications and penalties for not meeting the criteria need to be carefully spelled out. The clearest possible statement of the separation between those maintenance responsibilities to be borne by the state and those to be borne by the contractor are a key to successfully maintaining the concession facility.

Bleeding the capital facility is a favorite way concessionaires use to enhance the cash flows from their contracts. Briefly this means under performing their contractual maintenance responsibilities and pocketing the unspent maintenance funds as additional profits. This is a most insidious strategy to combat since in many cases the unperformed maintenance is not apparent to the casual observer until it builds up to the point at which the facility clearly suffers. This allows the concessionaire to bleed you in an undetected manner for some time before you even become aware of it. Bleeding the capital facility is most attractive to concessionaires near the end of their contracts because they can get away with it for a short term.

Possessory interest in government facilities is defined as the investment of private capital in structures and facilities that cannot be reasonably removed from the government owned land upon which they are located. Such an interest can, theoretically, be passed on to a new concessionaire at a price in a competitive bidding process.

The National Park Service has for eighty years granted possessory interest in the construction of customer serving facilities on federally owned land in National Parks. It has had major negative experiences with the failure of concessionaires to maintain facilities they had possessory interest in. These resulted in public buy-outs of the facilities accompanied by very critical legislative hearings and actions.

The State of Ohio has routinely kept all facilities in public ownership, although it has attempted to grant possessory interest on four occasions. Of these four, the State of Ohio was successful in only one of these attempts, which required the contractor to complete a major marina project by providing and installing boat docks. It is believed the three other attempts were unsuccessful because of the high amounts of investment required for the projects which included major infrastructure work, and the low projected amounts of return on those investments.

The State of Ohio recognizes additional risks in granting possessory interest. Contractor default during construction may lead to the government's costly purchase of an incomplete facility after lengthy litigation. Construction can lack the quality needed for a long term operation. The amount of investment often dictates a lengthy contract, which is unattractive if the operation is mediocre. It is the author's professional experience that due to the risks which can have long term affects, possessory interest is to be avoided.

In today's cash-short public sector the attractiveness of having a private business come in and build a facility on public lands with private investment is very alluring in the short term. It is the long term problems associated with possessory interest of poor construction, bleeding of the capital facility, and inability to pass such facilities on to another contractor through the bid process that plainly indicate that possessory interest is not in the long term interests of the taxpayers.

Using non-financial selection criteria, if your governmental laws permit, in a documented process of bid evaluations is probably the possible way to ensure the most qualified contractors will be selected. The ideal we strive for is to award to the contractor who will deliver the best combination of the highest quality of services to customers and the greatest financial return to the taxpayers. The use of nonfinancial bid evaluation criteria is the key to implementing this strategy. Critical to the successful use of such criteria is to have carefully documented bid evaluation process which will stand up to the inevitable court test. We have been quite successful in Ohio with a process which is highlighted in the exhibits.

Examples of bid review criteria and condensed concessionaire contract terms are included at the back of this paper as exhibits.

3. MANAGING PRIVATIZED CONTRACTS ONCE IN PLACE

Communications and coordination with your contractors is the golden key to getting good contract results. The more you stay in touch with any contractor or concessionaire the more likely you are to have a successful relationship. Both you and your contractor know that the bid specifications and contract language cannot possibly contain all the nuances and information, especially in the constantly changing environments we both work in, to adequately provide for a mutually satisfying relationship. You have to work together productively for the contractor to get to know what acceptable contract performance is and for you to know what the contractor can perform within his financial and organizational capability.

Inspection is a significant part of this relationship. If you sit in your office and try to manage any contract by exception all you will do is wind up waiting for complaints to come in. If you employ management by abandonment you can count on getting complaints. You have to have someone out there following what the contractor is doing with a reasonable investment of time. Without the direct feedback you are at the mercy of the complaining public or employees.

What do you do when the contractor doesn't perform? The idea that any governmental agency is going to take any private business contractor to court and get him defaulted out of the contract for nonperformance is a non-starter. The governmental agency will first be advised by the legal people that it is not cost effective and that the contract language (no matter that they may have approved several years ago) isn't strong enough to make a case. Such cases always hinge on the subjective nature of contract language regarding performance evaluations. There has been no way discovered to avoid such subjective language. Secondly the agency will be advised by the elected political folks that they will not win a contest in the media that pits "a small family businessman with children to feed" against a large unknowledgeable and unfeeling governmental agency. Endless second chances will simply be imposed upon the situation.

However, there are ways you can cope. Chief among them is the use of any contract language under which the contractor owes the state money, either for penalties or for fees or pass throughs. The legal people take an entirely different view of a contractor defrauding the taxpayer of money - as opposed to just your subjective professional evaluation that he is not performing. The same view also affects the media. If the contractor fails to pay you any money under any aspect of the contract you can generally get rid of him. That means when you write the contract clearly spell out cash flows and cash penalties. Even small ones are very useful when default time comes.

Contractors work hard at putting political pressure upon agency managers. If you can get pro active in default cases you can reverse this process. Politicians do not like to be associated with a disaster. If you can convince them that the taxpayers and voting customers are getting wronged and are writing letters about it, the politicians can be your best supporters in getting rid of a defaulting contractor. Too many times government managers wait until the contractors assault them through the political process rather than being pro active and getting the facts out early and often and building support for their necessary action.

Buy outs are something that isn't done often, but that is an excellent tool. This is especially the case if you demonstrate to your legal people that a low cost buy out saves the state money from contract defaults, negative cash flows, or court action. Interestingly enough, contractors behind in their cash payments or facing a nasty fight from you over contract compliance terms will terminate their contracts for a surprisingly small amount of up front cash or a waiver of some portion of their debt. The savings to the taxpayer is obvious.

Managers sometimes get committed to grinding the contractor down and perceive a buy out as throwing in the towel. They need to step back and refrain from viewing things as a contest and simply look at it from the taxpayers' eyes. What is the least cost way we can improve customer service and protect taxpayer investment? Sometimes that is a buy out.

In closing, privatization is just one more tool that park managers can use to provide quality customer service and be the best possible stewards of the taxpayers' investments.

KEY CONSIDERATIONS OF PRIVATIZATION

The decision to privatize must be a well informed one, which takes into consideration the following:

- Financial result of contracting/concessioning vs. self-operation
- Quality of services to be provided
- Expectations of the customers and the ability and willingness of a government agency or contractor/concessionaire to meet those expectations
- Length of contract term (the shorter the better).

A successful contract:

- is profitable to the contractor/concessionaire
- must be inclusive in its intent of all necessary requirements and provisions
- demands good communication between the parties
- allows for a system of rating the performance of the contractor
- is awarded based on multiple criteria, not just financial considerations.

BID REVIEW PROCEDURES

In reviewing bids, the following criteria, listed in descending order of importance, are used:

1. Monetary benefits to the State.
2. Financial capability of the bidder, including debt ratios.
3. Experience in the same type of operations and qualifications of key personnel.
4. Marketing plan and resources devoted to marketing Ohio.
5. Quality of operations elsewhere and experience in local area.
6. Overall operating plan.
7. .Location of supervisory office in Ohio.
8. Plan to hire in Ohio and the use of Ohio sources for supplies and materials.
9. Whether the bidder is a Minority Business Enterprise (MBE), and the bidder's use of minority owned businesses.
10. .Whether the bidder is a Female Business Enterprise (FBE), and the bidder's use of female owned businesses.
11. Experience, examples and plan for ensuring quality customer service.
12. Experience, examples and plan for ensuring cleanliness of facilities.
13. Experience, examples and plan for ensuring quality maintenance of facilities.
14. Employee hospitality training plan.
15. Equipment preventive maintenance plan.
16. Contingent liability (legal problems).
17. Table of organization for property managed.
18. Up front investment and details.
19. Proposed prices and rates.
20. Other services to be performed.

DEER CREEK RESORT REVENUE DATA AND CONTRACT SUMMARY

Resort Features:

110 guest rooms, 25 two-bedroom cabins, Harding Cabin, kitchen and dining room, meeting rooms, gift shop, lounge-bar, indoor and outdoor swimming pools, tennis courts, boat courtesy dock.

- **Contract term** - 10 years
- **Gross Revenue** - 1995: $4,758,069.02
- **State's Commission**:
  - 30.0% of Room and Cabin revenue
  - 5.0% of Food and non-alcoholic beverage revenue
  - 27.1% of Alcoholic beverage revenue
  - State's commission in 1995 = $902,560.48
- **Maintenance, Repair and Replacement Fund** - 10% of total gross revenue
- Concessionaire pays for all utilities, labor, retail merchandise, permits, licenses, maintenance costs not permitted from MR&R Fund, and all other operational expenses.
- **Advance Deposit Fund** - required to cover advance deposits held by Concessionaire; in the amount of $150,000.00.
- **Guarantee Fund** - required to ensure Concessionaire's compliance with contract terms; in the amount of $300,000.00.
- **Maintenance responsibilities of the Concessionaire** include:
  - all routine electrical, plumbing and mechanical costs, and swimming pool maintenance;
  - painting and routine maintenance of the interior and exterior of structures;
  - maintenance of roofs, gutters, downspouts, and windows; flat roof replacement;
  - snow removal and all grounds maintenance, with exception of parking lot repaving;
  - repair and replacement of all furnishings, fixtures and equipment;
  - refuse storage and removal;
  - obtaining service contracts to maintain HVAC systems, fire suppression, elevators and wood shake roofs.
  - all cleaning required to preserve the structures and equipment.

- **Maintenance responsibilities of the Department** include:
    - major structural repair, shake roof replacement, lodge boiler and main chiller replacement; and correction of extreme erosion conditions;
    - surface maintenance of parking areas, roads and drives, and snow removal from main roadways.
- **Liability insurance** - Concessionaire must maintain comprehensive general public liability insurance covering its operations; such insurance shall have a single limit of not less than $10,000,000.00.
- **Indemnification** - The Concessionaire assumes, pays and at all times indemnifies, protects, and saves harmless the Department from and against any and all claims, actions, damages, liability and expense in connection with death, personal injury, and/or damage to property.

SALT FORK RESORT REVENUE DATA AND CONTRACT SUMMARY

Resort Features:

148 guest rooms, 54 two-bedroom cabins, kitchen and dining room, meeting rooms, gift shop, lounge-bar, indoor and outdoor swimming pools, snack bar, tennis courts.

- **Contract term** - 10 years
- **Gross Revenue** - 1995: $5,309,800.79
- **State's Commission**:
    - 31.3% of Room and Cabin revenue
    - 6.0% of Food and non-alcoholic beverage revenue
    - 15.0% of Alcoholic beverage revenue
    - State's commission in 1995 = $1,145,323,60
- **Maintenance, Repair and Replacement Fund** - 10% of total gross revenue
- Concessionaire pays for all utilities, labor, retail merchandise, permits, licenses, maintenance costs not permitted from MR&R Fund, and all other operational expenses.
- **Advance Deposit Fund** - required to cover advance deposits held by Concessionaire; in the amount of $225,000.00.
- **Guarantee Fund** - required to ensure Concessionaire's compliance with contract terms; in the amount of $300,000.00.
- **Maintenance responsibilities of the Concessionaire** include:
    - all routine electrical, plumbing and mechanical costs, and swimming pool maintenance;
    - painting and routine maintenance of the interior and exterior of structures;
    - maintenance of roofs, gutters, downspouts, and windows;
    - snow removal and all grounds maintenance, with exception of parking lot repaving;
    - repair and replacement of all furnishings, fixtures and equipment;
    - refuse storage and removal;
    - obtaining service contracts to maintain HVAC systems, fire suppression, and elevators;
    - all cleaning required to preserve the structures and equipment.
- **Maintenance responsibilities of the Department** include:
    - major structural repair, roof replacement, lodge boiler and main chiller replacement; and correction of extreme erosion conditions;
    - surface maintenance of parking areas, roads and drives; tennis court resurfacing; and snow removal from main roadways.
    - **Liability insurance** - Concessionaire must maintain comprehensive general public liability insurance covering its operations; such insurance shall have a single limit of not less than $10,000,000.00.
- **Indemnification** - The Concessionaire assumes, pays and at all times indemnifies, protects, and saves harmless the Department from and against any and all claims, actions, damages, liability and expense in connection with death, personal injury, and/or damage to property.

Figure 1. Bid Evaluation Form

Bid Evaluation
Bid # __________-__________

Category	Max. Points	Bidder #1	Bidder #2	Bidder #3
Monetary Return to the State	1560			
Supervisory office in Ohio	30			
Table of Organization	30			
Whether MBE	30			
Whether FBE	30			
Hire Ohio and "Buy Ohio"	30			
Experience & Qualifications	240			
Plan of Operation	180			
Proposed Prices and Rates	30			
Other Services Proposed	30			
Marketing Plan	180			
Quality Customer Service	30			
Quality Cleanliness	30			
Quality Maintenance	30			
Equipment Maintenance Plan	30			
Employee Training	30			
Up Front Investment & Details	30			
Credit References	No Points			
Quality of Operations (Refer.)	180			
Contingent Liabilities	30			
Financial Liabilities	240			
Pro forma Projections	In Plan of Operations			
Total	3000			

Glen D. Alexander, Chief Date