



# Understanding bidder behaviour: The case of the Mamelodi contract

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# Overview of the presentation

- Brief overview of public transport contracting in SA
- Public transport contracting risks
- Background to the Mamelodi contract
- Characteristics of the contract design
- Results of the bid process
- Discussion of the results
- Conclusions



# Brief overview of public transport contracting in SA

- Prior to 1997 operators had **indefinite rights to operate services**
- **Government adopted tendering and contracting in its White Paper on National Transport Policy of 1996**
- **In 1997, Interim contracts were concluded with all subsidised operators** as a transition measure to full tendering (passenger based – the more pass. transported the higher the claimable subsidy)
- **Tendered contracts were awarded between 1997 and 2001 and negotiated contracts until 2003, although there were a few tendered contracts prior to 1997 of which the Mamelodi service was one. These were all km-based.**





# Brief overview of public transport contracting in SA

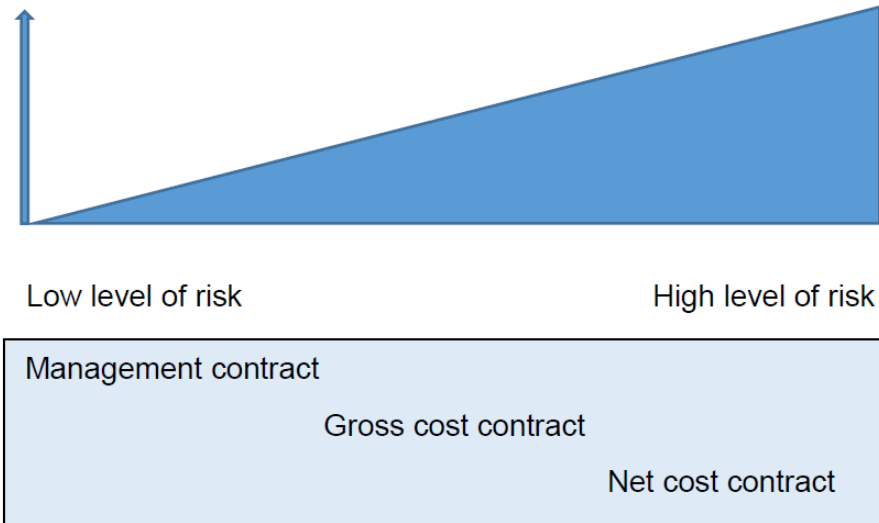
- A moratorium was place on new tendered contracts in 2001 due to funding issues
- To date there are about 66 tendered contracts, 10 negotiated contracts with the remainder (39) being interim contracts concluded as far back as 1997.
- In 2009, all non-tendered contracts were converted to km-based contracts and “capped” in terms of overall kilometres and annual increases based on the Public Transport Operations Grant (PTOG).
- The annual increase in the PTOG is determined by National Treasury without consideration of industry cost structures/increases
- The Mamelodi contract was the first tendered contract issued since 2001



# Public transport contracting risks

- **Risk management is especially important in net and gross cost management** – both from an authority and operator's point of view and depending on the nature of the contract (gross vs net)
- **In net cost contracts the operator bears the revenue and cost risks thus placing a greater responsibility on the authority to supply dependable information** to potential bidders in order to achieve cost effective and cost efficient bids

Level of risk borne by the operator



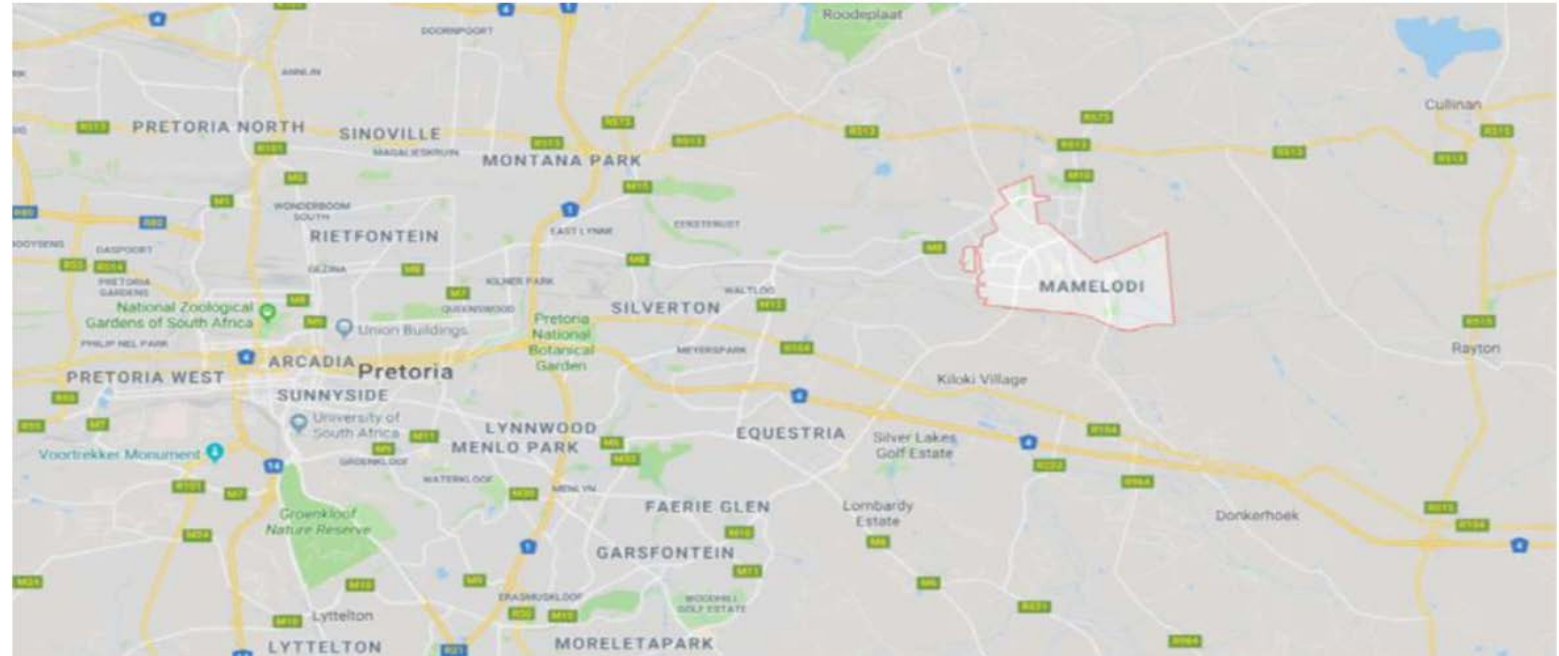
# Public transport contracting risks

- Risks manifest themselves as:
  - **Revenue risks** – demand revenue (number of passengers), fare evasion and fares
  - **Cost risks** – fleet requirements, vehicle kilometres and price of main inputs such as driver costs, fuel and labour, infrastructure etc.
  - To address revenue risks some contracting regimes have **adjusting mechanisms** in place to reduce the operator's exposure to uncontrollable externalities e.g. changes in input costs and potentially poor/inaccurate contracting data
  - In a recent study among bus operators in SA it was found that **operators hold strong views on both the revenue and cost risks embedded in contracts**



# Background to the Mamelodi contract

- Mamelodi is township to the east of Pretoria and has a population of about 335 000 people over 45 square km



- The township is served by rail, bus and minibus taxi services
- Bus services operate to Centurion, Midrand and Pretoria central, north and east
- The service was put out to tender in December 2017 and tenders had to be submitted on 12 January 2018 (this is a major holiday period in SA)



# Characteristics of the contract design

- The service design made provision for **77 buses (shifts)** with a **10% spare capacity** to be provided
- **Basic information about the number of kilometres and passengers per route was provided**
- **For 24 of the 77 shifts limited information was available** and bidders had to verify route distances and passenger loads for these shifts
- **No guarantee of the accuracy of the information**
- The contract was a **net-cost contract** over a 7 year period
- A requirement was that bidders had to have a **30% set-aside/sub-contracting arrangement** with small operators in place **when they lodged their bids**
- The contract did not specify an **escalation clause** and relied on an annual increase determined by SAs National Treasury in the PTOG (not linked to the cost of bus operations)
- **Bidders had to submit the contract value for the first year of operations**
- **The subsidy available for the service was R 37,4 million per year (before escalation)**  
(about US\$ 2,6m)





# Results of the bidding process

- **Attempts were made to obtain the bid-information of the bidders from the authority or the institution that designed the tender** but due to non-disclosure agreements they were unable to assist
- **A list of bidders and contact information was however supplied** by the authority and interviews were conducted with **5 of 8 bidders for the service**
- **Major differences in key revenue and cost drivers were evident from the information supplied by the 5 bidders.** This had a negative effect on overall tender prices as operators shifted these risks to the authority by way of higher subsidy requirements
- **The contract was not awarded** due to the unaffordability of the bids to the authority
- The following table sets out key financial and operational information of the five bidders:



# Results of the bidding process

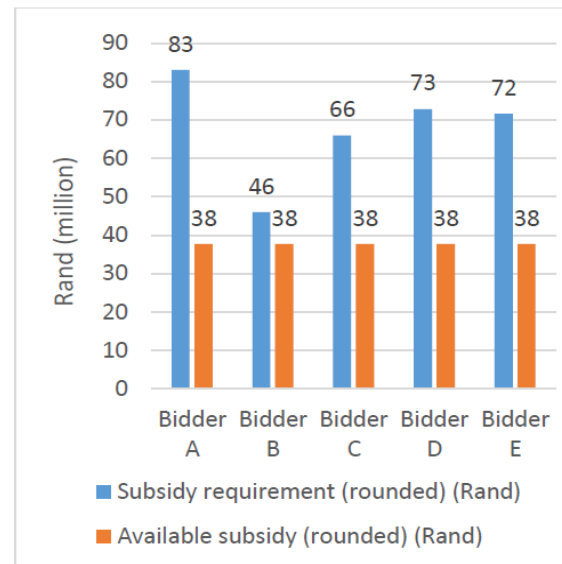
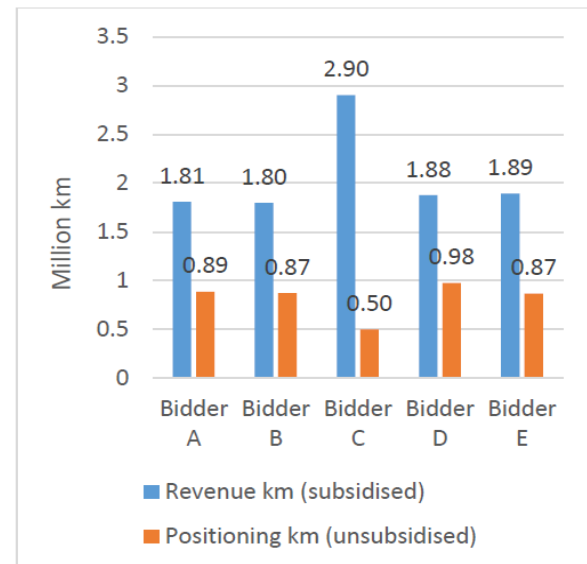
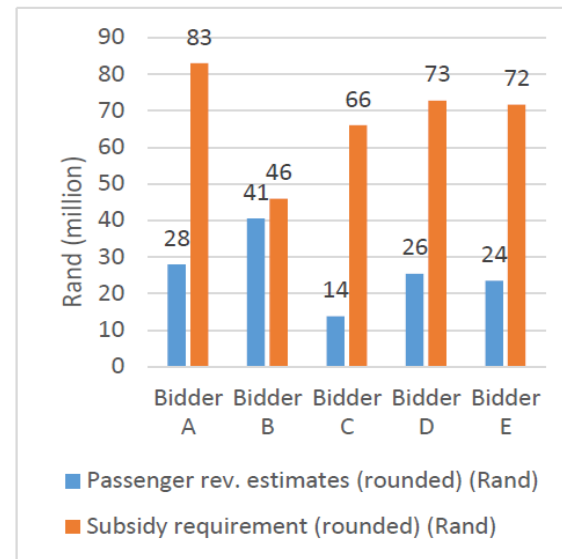
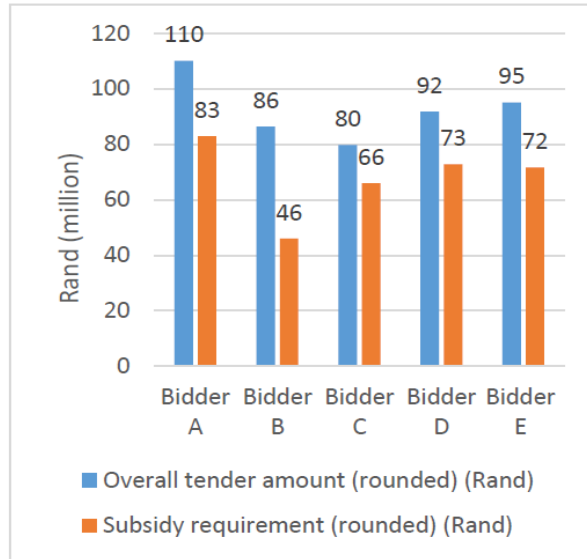
- Operational and financial data of the respective bidders (at the end of the first year of the seven year contract)

	Bidder A	Bidder B	Bidder C	Bidder D	Bidder E
Revenue km (subsidised)	1 805 738	1 798 777	2 900 000	1 876 092	1 893 189
Positioning km (unsubsidised)	888 157	874 166	500 000	976 212	867 000
Total km	2 693 895	2 672 943	3 400 000	2 852 304	2 760 189
Annual passenger trip estimates (cash and seasonal)	397 760	2 705 400	715 000	970 652	330 300
Passenger revenue estimates	R 28 000 000	R 40 581 000	R 13 872 000	R 25 502 096	R 23 500 500
Subsidy requirement	R 83 000 000	R 46 000 000	R 66 000 000	R 72 843 872	R 71 660 000
Subsidy/pass trip estimates	R 208.67	R 17.00	R 92.31	R 75.05	R 216.95
<b>Subsidy as % of overall tender amount</b>	<b>75.35%</b>	<b>53.25%</b>	<b>82.63%</b>	<b>79.25%</b>	<b>75.30%</b>
Overall tender amount at the end of the first year	R 110 149 535	R 86 390 805	R 79 872 000	R 91 912 120	R 95 160 400
<b>Subsidy as % of available subs.</b>	<b>+120.2%</b>	<b>+22.0%</b>	<b>+75.1%</b>	<b>+93.2%</b>	<b>+90.1%</b>
Available subsidy from the TA	R 37 700 000	R 37 700 000	R 37 700 000	R 37 700 000	R 37 700 000

Source: Compiled from data supplied by bidders



# Results of the bidding process



# Discussion of the results

- Five main areas of concern were raised by the bidders during interviews:

## (1) The contract escalation clause

- The reliance on the escalation via the Public Transport Operations Grant (PTOG) was seen as problematic for a seven year contract as the escalation had no bearing on the input costs and therefore the main cost risks the operators were to face

**Table 2: Comparing the December year-on-year PTOG percentage increase to percentage increases in Headline CPI, fuel and wage costs**

% Change	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
PTOG (See note a)	-6.00 (See note e)	5.10	5.00	3.05	4.45	6.15	2.21	9.33	5.97	3.24
Headline CPI (See note b)	7.1	4.30	5.00	5.60	5.70	6.10	4.60	6.40	5.30	4.70
Fuel Price Increases/decrease (See note c)	-16.9	8.1	37.89	8.59	10.19	1.28	-17.4	1.94	17.51	13.30
Wage increases (See note d)	11.00	10.00	9.00	8.50	10.00	9.50	9.00	8.20	9.00	9.00

+/-  
70%  
of  
costs

Sources: (a) Division of Revenue Acts (2009-2018); (b) Statistics South Africa (2009 – 2018); (c) Department of Energy. Wholesale Price of Diesel. December year- on-year (Gauteng pricing); (d) Annual Wage settlements: Bargaining Council for the Road Passenger Transport Industry (SARPBC); (e) At the introduction of the PTOG in 2009, the overall available subsidy was 6% lower than the previous year's subsidy



# Discussion of the results

- Five main areas of concern were raised by the bidders during interviews:

## (2) Data correctness

- There was **no guarantee on data correctness** and there was **no adjustment mechanism** for potentially inaccurate data
- Bidders regarded the **revenue risk as problematic as little or no information was available about 24 of the 77 shifts**. They could not verify passenger data as the tender was put out over a major holiday period.
- Cost and especially revenue risks were shifted to the authority due to this uncertainty

	Complete passenger revenue data	Incomplete passenger revenue data
Total cost of producing the service	R 100 000 000	R100 000 000
Total passenger revenue (what it could have been based on detailed information)	R 50 000 000	
Passenger revenue estimates (based on the best estimate of the operator)		R 20 000 000
Authority subsidy required	R 50 000 000	R 80 000 000



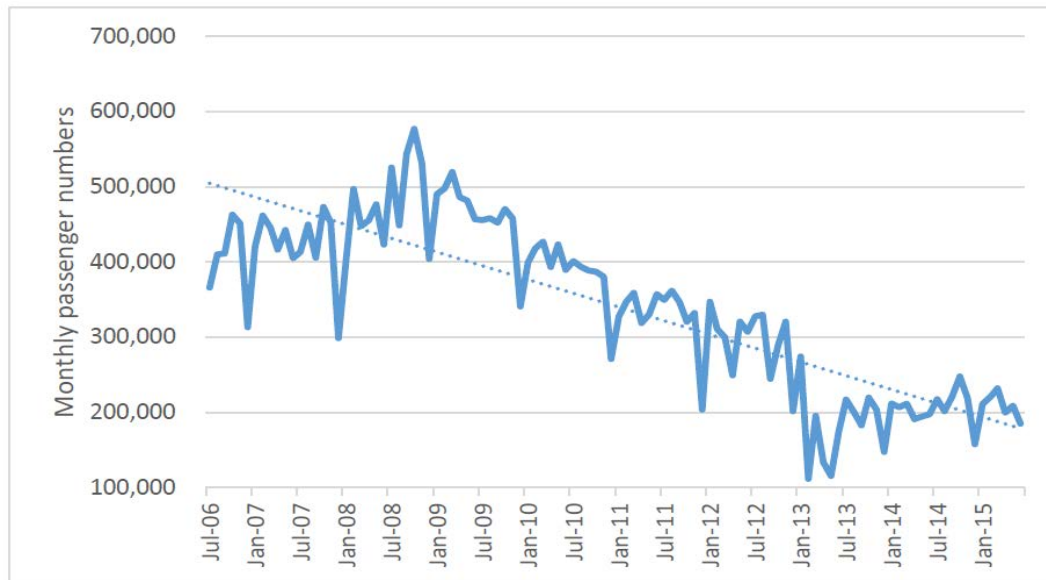


# Discussion of the results

- Five main areas of concern were raised by the bidders during interviews:

## (3) Lack of a mechanism to adjust data

- **The contract did not include a mechanism to adjust especially passenger data** should passenger numbers be lower or higher than estimated by the bidder and or authority
- **Passenger trips in the Mamelodi area has been reducing over the years** due to the inroads made by the minibus taxi industry



## Discussion of the results

- Five main areas of concern were raised by the bidders during interviews:

### **(4) Sub-contracting 30% of the service**

- **Only one bidder could submit a tender with all of its sub-contracting arrangements in place** but was one of the higher bids and the bid contract was not awarded
- **All the other bidders were excluded from the evaluation as it was a pre-condition for the bid to be considered by the authority**

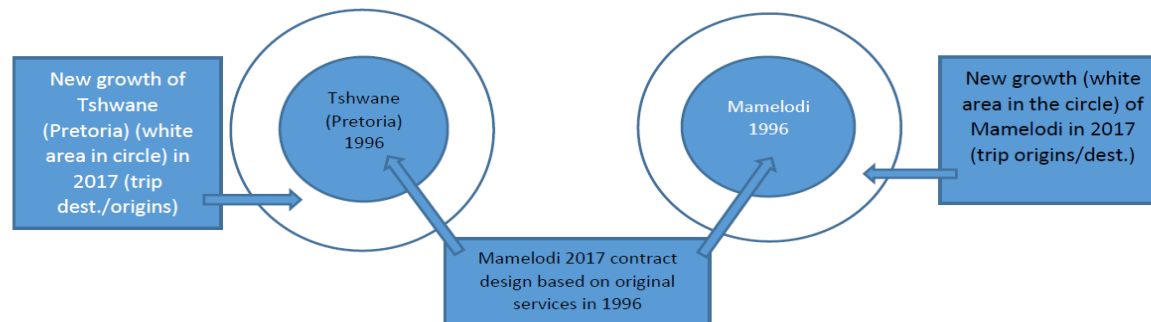


# Discussion of the results

- Five main areas of concern were raised by the bidders during interviews:

## (5) Additional services

- The bid was designed mainly based on the **scope of the original contract design (1996)** and did not take into account potential additional services in the service design due to in-migration into the area



Source: Author's construct



# Conclusions

- **Contract conditions such as the 30% set-aside pre-qualification requirement** complicated the entire bid process- alternative ways need to be sought to accommodate this requirement
- The lack of an **appropriate escalation clause** was seen as problematic by the bidders
- **Poor contract design, poor information and the inappropriate apportionment of risks affected the contract's pricing**
- Authorities need to understand **how bidders view the characteristics of their contract designs, especially operating conditions, contract specifications and revenue and production cost risks (especially in net cost contracts)**
- **Authorities also need to learn from each contract how bidders viewed their designs and how it affected their cost and revenue estimates** in order to improve their designs and appropriately apportion contracting risk to the party/ies that could carry these risks the best





A photograph of a university campus featuring a row of modern, multi-story concrete buildings with balconies. In the foreground, there is a paved area with a circular fountain, surrounded by lush green trees and bushes. A few people are visible walking in the lower left. The sky is bright with some clouds.

**Thank you**



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