Should Your Lemonade Stand Consider Privatization?

Imagine that you are a child selling lemonade in your neighborhood. During the summer months, you find yourself understaffed because of the high demand. Your staff of recruited neighborhood kids is overworked trying to produce enough lemonade, and the quality of your lemonade is suffering as a result. Worse yet, several of the neighbors have filed complaints about the customer service at your stand. During the down time in the colder months your stand is overstaffed, but you don’t want to deal with letting anyone go. This fluctuation makes budgeting difficult and you find yourself running at a substantial financial deficit while you wait for the warmer months to return.

Now imagine that there was an opportunity to bring in a group of neighborhood kids you could partner with to increase customer service, bolster the quality of your lemonade, handle staffing and activity fluctuations, and save money. These are kids from your local area and they don’t want to monopolize the lemonade stand business – it will still be your stand. But these kids have worked at lemonade stands before, so they can keep your stand running more smoothly.

For a kid’s lemonade stand, this kind of outsourcing is clearly a good idea. Other kinds of outsourcing – say, community development – are a bit more complex. Still, the ideology and concept behind this analogy is useful when approaching the way a jurisdiction’s building department operates.

Defining Privatization

Any time a local government contracts with outside companies or agencies to perform services (instead of the jurisdiction’s own employees doing the work), it is using an alternative service delivery model. There are many ways to define alternative service delivery, and many officials and communities casually interchange these terms. Definitions are frequently blurred, which can create a level of confusion. Privatization is an umbrella term for a range of policy choices that involve shifting some responsibility from the government to the private sector, or some form of partnership to accomplish certain goals or provide certain services.

Privatization encompasses transferring or selling public assets or asset management rights to a private-sector entity in exchange for financial, liability transfer, and risk mitigation benefits.
Privatization is a tool that can be effective when used well and ineffective when used incorrectly. Many communities have relied on contracted providers for services such as solid waste collection and disposal, street repairs, and utilities for years, and with the budgetary issues many local governments still face after the Great Recession, communities are evaluating whether it makes sense to privatize other services as well.

The GFOA has recognized that the need to provide cost-effective options while maintaining expected levels of service can cause governments to search for alternative service delivery options, and that with the proper research and due diligence, it can provide numerous advantages. Benefits can include service improvements, a means of accommodating fluctuating seasonal peak demands, access to outside expertise, and new insight into innovations. Privatization can mean having the right numbers of employees, with the right expertise, when you need them.

Outlining clear performance metrics in the contract allow a government to make sure that quality thresholds and expectations are met, including outstanding customer service.

The New Jersey Privatization Task Force published a report in May 2010, concluding that "through sensible planning and implementation, privatization offers a variety of benefits to governments and taxpayers, including lower costs, improvements in the quality of public services, and access to private-sector capital and professional expertise.” The task force noted numerous examples of privatization projects that were done well, but it also gave examples of failures. The issues were similar for each of these unsuccessful initiatives: poor conception, unclear goals, superficial due diligence, inexperienced and/or undercapitalized contractors, lax oversight, and, on occasion, conflicts of interest. Other significant concerns are the possibilities of creating monopolies, or situations that are counter to the public interest.

Another major concern for the public sector when evaluating privatization deals is displacing workers. To address this, governments need to develop safety net programs such as retraining, reassignment, and early retirement, and make them available to employees as soon as possible. When privatization is being discussed, employees are likely to feel that they are being mistreated and cast off for the sake of reduced costs. Many long-time government employees have expended considerable energy in providing public service, and they should be treated fairly. A thoughtful and well-planned transition should make layoffs an option of last resort.
The New Jersey task force\(^3\) and the GFOA best practices\(^4\) both make recommendations for ensuring that privatization works in the best interest of all parties. Governments need to go into any such deal with a thorough understanding of the potential cost savings, service quality improvements, and risks. One of the most important safeguards is effectively managing the process, ideally by establishing an entity to continually evaluate performance and ensure that privatization deals are performed consistently, according the government’s carefully considered policies, and followed by the private agent. This includes requiring a firm business case and a rigorous cost-benefit analysis for any proposed privatization. Effective management and monitoring includes continued communication and reporting with interested parties throughout the privatization process. Governments need to consult best practices regarding project analysis, vendor selection, contracting, and performance monitoring and oversight.

THE TALE OF TROY

One of the most significant outcomes of a well-executed privatization program, and the focal point of this article, is cost savings. Financial savings are often realized through economies of scale, access to cutting-edge technology the government wouldn’t have been able to afford on its own, innovations, or simply a different way of completing the job. Reduced labor costs can help a jurisdiction better manage its financial burdens. Following are examples of two communities that have privatized their building department services – a change more and more jurisdictions are considering.

**Troy, Michigan** is the largest city in Oakland County, with a population of 82,212. Before 2010, Troy’s building services department was operating at a substantial deficit; the city’s comprehensive annual financial report from June 30, 2010, reported a cumulative shortfall of $6.6 million, caused by years of increases in employee costs, pensions, and related operational costs. Troy had grown quite a bit in previous years, and that expansion had required additional full-time staff, all union positions.

When the economy and construction slowed, staffing could not be adjusted in the same timely manner, so the city was now overstaffed. The situation was not sustainable for the long term.

City officials recognized many areas where improvements could be made, and they hired a consulting service that specializes in the areas of municipal organization, management, and process studies to evaluate all departments and make recommendations. The consulting company suggested a number of options for the building services department, but none were embraced by staff or by the union. The city asked the department to implement some of the recommendations and to meet the consultant’s privatization offer for running the department, but nothing changed. City officials then decided to privatize the building inspections department.

The private firm manages the daily operations of the building department, performs inspections, plan reviews, staffs the front counter, archives city records, and works with city officials on departmental budget. The firm also works with the economic development department to encourage growth and promote business opportunities within the community. In return, the firm receives a percentage of the city’s excellent service and cost efficiency go hand-in-hand. By looking for ways to improve the department’s processes and create efficiencies, the private firm helped bolster the department’s financial performance.
permit fees. This fee structure means that Troy never has to worry about building department costs exceeding revenue, even with fluctuations in building activity. In other words, the firm turned the city’s fixed costs into variable costs based on activity levels.

Excellent service and cost efficiency go hand-in-hand. By looking for ways to improve the department’s processes and create efficiencies, the private firm helped bolster the department’s financial performance. For example, reconfiguring the department’s office space within city hall has improved its workflow to the point that it is now using half the square footage to accomplish the same amount of work. Thousands of paper records were scanned for more efficient archiving and retrieval. Inspectors were equipped with wireless laptops so they could access and enter information in the field. Many of these changes were based on the consulting firm’s initial recommendations.

One of the main recommendations for making the department work more efficiently regarded staffing changes. At its peak, there were 21 full-time staff members in the building department. There were some vacant positions when the consultant took over. The department currently has nine full-time employees and an "floater." The private firm that took over operation of the department interviewed and retained a number of building inspectors who were originally with the department, and the other employees either retired or were redeployed to other city departments.

Another way to save money is to have departments work together. Troy has improved interdepartmental and intergovernmental relations through better communication, and as a result, permit technicians disburse permits for water and sewer, planning, and for other city departments as well, improving the flow of information among city workers and saving time and money. The private firm operating the building department has built upon this improvement, streamlining work processes to reduce processing time.

The changes saved the city of Troy’s building inspections budget $1 million in fiscal 2010-11, the first year of the contract. City officials understood that the way the building services department had traditionally provided services is not in all cases the most efficient. By privatizing these services and allowing greater efficiency, the city addressed the reduction in tax and state revenues, and it enabled more efficient and customer-friendly operations.

### HOW IS YOUR STAND OPERATING?

While the lemonade stands run by the neighborhood children may not actually be turning to privatization, jurisdictions across the country are finding it to be an effective and efficient way of dealing with financial challenges. Privatization is certainly not for everyone, but few organizations wouldn’t benefit from asking themselves if there is a better way to operate. When done correctly, privatization is a tool for improving service levels, realizing cost savings, and dealing with fluctuating activity levels and demands.

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5. The financial data for Peachtree City, Georgia, come from the city’s fiscal 2010 and 2010 budget documents, which are available at [http://www.peachtree-city.org/DocumentCenter/index/11](http://www.peachtree-city.org/DocumentCenter/index/11).