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Internal delegation contracts for water in Uganda

An innovative approach to establishing a successful public utility

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Uganda's national water utility has become known for its successful turnaround under public management. Less well known is that this success owes much to the introduction of private-sector-like practices to motivate employees. Following a mixed experience with two short-term management contracts in Kampala, the utility's management introduced an innovative concept of internal delegation, inspired by public-private partnership contracts. Local managers establish private partnerships to operate systems under contract with the utility, with part of their pay depending on performance. The experience offers interesting lessons for those involved in reforming urban water utilities in developing countries.

Uganda's water infrastructure was deeply affected by the civil war during the 1980s, and the return to normalcy in the following decade brought little progress. The country's National Water and Sewerage Corporation (NWSC) was a typical poorly run state-owned utility. More than half the urban population lacked access to piped water—and water rationing was widespread, water not potable, and customer service dismal.

Two management contracts mixed results

In 1998 the government decided to appoint a new general manager at NWSC, with a clear mandate to modernize the utility. This appointment coincided with the signing of a three-year management contract with a German consulting firm. The contract, negotiated by the previous management team, focused on modernizing commercial practices in Kampala. It was followed in 2001 by a two-year management contract awarded to an international private operator (Suez) to handle water distribution and customer management in Kampala. Thus between 1998 and 2003 the utility was operated under two different modes: a private operator handled water distribution, billing, and collection in Kampala, while water production in Kampala and all services in secondary cities and towns remained under the direct control of NWSC headquarters.

The two management contracts, designed and awarded without assistance from donors, had many design flaws. They proved difficult to implement, with tense relationships between expatriates and local staff. The second contract was adjusted for some of the shortcomings of the first, with clearer lines of command and a special fund for emergency rehabilitation. But it was of short duration and had a modest impact. Although some improvements were achieved, notably in bill collection, most indicators fell below the contractual targets.

Birth of the internal delegation concept

The presence of a foreign private operator in Kampala for a few years had one advantage: it gave the new management at NWSC an oppor-

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tunity to focus its attention on improving services outside Kampala. It began an experiment with area performance contracts (APCs) in 2000, with the rationale that motivating employees was essential to achieving good performance. APCs were basically one-year performance agreements with local management teams, with bonuses and penalties (of up to 25 percent of basic salary) based on targets. Local managers were given more authority to make operational decisions and also made accountable for outcomes. This initiative was accompanied by programs to promote best practices, emphasize teamwork, and recognize the best performers.

Under the APCs, the operational performance of NWSC improved significantly in secondary cities—much more so than in Kampala under a foreign operator. Nonrevenue water was reduced from an average of 32 percent to 22 percent in less than three years, while no significant change was achieved in Kampala. Bill collection also improved dramatically. While these were small systems, much easier to operate than the complex infrastructure in Kampala, the results were encouraging.

Scaling up internal delegation

The second management contract was not renewed when it expired in February 2004. Instead, NWSC decided to expand the internal delegation approach to all NWSC systems, including Kampala, through a second-generation scheme, the internally delegated area management contract (IDAMC). The idea was to build on the APC concept by designing contracts that mimicked a management contract with a private operator (box 1).

The contractual design of IDAMC, inspired largely by the former management contract with Suez, was drafted by a task force of NWSC staff. The main idea was to foster the principles and practices of efficiency, accountability, and financial viability in the provision of services by transferring operating risk to teams of committed individuals who would lose or gain financially depending on how they performed.

The adoption of the IDAMC concept effectively transformed NWSC's regional branches into a

The idea was to mimic a management contract with a private operator

BOX 1

How internal delegation contracts work

While the IDAMCs bear many similarities to the initial APC approach, there are also several fundamental differences. APCs were internal agreements between NWSC and area managers. IDAMCs are private law contracts between NWSC and a privately incorporated partnership. A deed of partnership detailing the duties, rights, and obligations of each partner is signed by the members of the management team.

As in a traditional management contract, the privately incorporated partnership acting as operator is responsible for running and maintaining the water infrastructure (production and distribution) and handling customer service (from reading meters to collecting revenues). NWSC remains responsible for making investments and setting tariffs. One difference from a true management contract is that headquarters still provides centralized services as well as funding for working capital. Another is that disputes are settled by the NWSC board rather than a court of law.

Under the IDAMC financial arrangement, operational costs (such as power, chemicals, maintenance, and the salaries of seconded employees) are borne by NWSC. The remuneration of the partnerships is essentially based on an incentive fee corresponding to a share of the operating cash flow—and depends on performance on five key indicators: cash operating margin, nonrevenue water, working ratio, bill collection, and percentage of inactive connections. There is also a performance fee based on savings achieved on a few administrative costs (such as vehicle fuel and telephone service) as well as performance in meeting some targets specific to each area.

Even though NWSC bears most of the operating costs, local managers still have strong incentives to reduce them because they directly affect the operating cash flow, the basis for calculating their remuneration. They also have direct incentives to maximize sales and revenue collection, improve bill collection, and reduce water losses and the proportion of inactive connections—all of which lead to better financial viability. The contractual targets and levels of risk transfer are adjusted on the basis of conditions in each area—with the variable portion of the partnerships' remuneration ranging from about 25 percent to more than 45 percent (as in Kampala and Entebbe) and bonuses for employees directly negotiated between unions and each local partnership.

TABLE 1
Key operational indicators for NWSC, 1998–2008

Indicator	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total connections (thousands)	51	54	59	66	75	87	101	123	152	181	203
Service coverage (urban, %)	47	50	54	57	60	63	65	68	70	71	72
Nonrevenue water (%)	50	46	43	43	41	40	38	34	30	33	34
Water losses per connection per day (cubic meters)	1.21	1.03	0.92	0.84	0.69	0.63	0.57	0.46	0.33	0.32	0.28
Labor productivity (staff per thousand connections)	36	27	21	17	15	11	10	9	7	7	6

Source: NWSC.

The reform recognized that motivating employees was crucial for success

series of quasi-private, ring-fenced, and autonomous business units. In each branch NWSC enters into a two-year contract with a team of individuals called "the operator"—a private partnership consisting of key staff headed by the area manager. The IDAMC terms replace those of the employment contracts of local managers, while lower-level NWSC employees are seconded to the operator appointed in their area.

Sustained performance gains

By 2002 NWSC had made sizable progress, thanks to the positive results of APCs in secondary cities. Starting in 2003, the implementation of IDAMCs raised its performance to a new level. While further gains were made in secondary cities, the biggest improvements were achieved in Kampala.

Water losses have fallen significantly. Nonrevenue water, already reduced from 50 percent to 41 percent between 1998 and 2002, was further reduced to 34 percent in 2008 (table 1).[1] Almost all customers are now metered, and bill collection for residential customers has been maintained at a high level (although, as in other African countries, irregular payments from government agencies are a continual problem). While the utility maintains a strict collection policy, it also makes every effort to negotiate with customers before cutting off service, resulting in a low rate of inactive connections (about 5 percent).

The introduction in 2005 of a free connection policy—to allow the poorest households to gain access to the water supply network and become regular customers—resulted in a remarkable expansion of service, with connections doubling between 2004 and 2008. By 2008, 72 percent of the urban population had access to piped water through a household connection, and more than 90 percent had access to an improved water source.

Labor productivity has improved considerably, standing at about 6 employees per thousand connections in 2008, down from 36 in 1998 and 15 in 2002. While half the employees were laid off between 1998 and 2002 (through a voluntary redundancy plan negotiated with unions), new and better-qualified staff have been recruited in the past five years to keep up with the fast-growing customer base.

NWSC has not benefited from any significant tariff increase over the past decade, with adjustments limited to inflation. Yet thanks to efficiency savings and a fast-growing customer base, the utility has been able to post an operating profit for six years in a row since 2003, having always been cash negative before. Although salary costs have grown significantly with the payment of bonuses under IDAMCs, this increase has been largely offset by the many efficiency gains in operation. The improvement in financial viability allowed NWSC to easily access donor funding to finance its continual expansion.

Lessons learned

The modest achievements of the two successive management contracts in Kampala show that bringing in a private operator from outside is no guarantee of success. Yet the utility management pushed forward by introducing private-sector-like

practices that mimicked the public-private partnership approach. As these became well accepted by employees, the reform turned into a major success.

Uganda's success with NWSC provides encouragement for other countries to experiment with the corporatization of public water utilities, designing schemes that suit their own situation and culture. The full story of the reform has been recently published (Muhairwe 2009). There is no prescribed blueprint—only a need to respect fundamental principles of efficiency, accountability, and financial sustainability. The originality of the Ugandan model lies in its introduction of sharp financial incentives for staff and its emphasis on private sector principles. The experience offers several important lessons:

- *NWSC became a successful public utility because of its strong commitment to operational efficiency and improvements in financial viability.* This commitment is well expressed in the motto chosen for the 2009–12 corporate plan: "maximize the operating cash flow." It underlines the importance for NWSC management of explaining to employees that increasing sales, improving bill collection, and keeping operating costs down are essential for the financial viability of the company.

- *Focusing on motivating employees through better incentives was central to the success of the reform.* Water utilities are in the service business. Workers are assets, and no lasting improvement can be achieved without their commitment and collaboration. Providing sizable financial bonuses is a fair and efficient way to motivate those who perform well. But it also requires enforcing penalties and sanctions (including dismissal) for those who do not. These two key elements are missing under traditional public management. Strong leadership together with a motivated team of employees was essential for promoting acceptance of this innovative, incentive-based approach.

- *Supervision of the local partnerships has been (and remains) a challenge.* NWSC had to learn how to properly monitor the private partnerships and deal with fraudulent reporting and abuse of autonomy by some local managers. The "checkers system," in which dedicated staff make unscheduled visits and audits, has proved to be an efficient approach. Since the start of the program, strict control by headquarters has led to the dismissal of three partnerships.

- *Internal delegation contracts require strong nurturing from headquarters.* This is one major difference from a contract involving a traditional private operator. Headquarters remains in charge of such essential functions as handling the customer database, procuring equipment, controlling financial flows, and, of course, handling investments. And major efforts are made to promote benchmarking between units, recognize the best performers, and share good practices.[2]

- *The long-term viability of NWSC remains dependent on government support.* Tariffs fully cover operation and maintenance costs but only part of investment, and the government has been closing the gap by financing the investment program—carrying donor debt on its own books. As a result, taxpayers, not users, have been paying for the investment program. This policy choice on who bears the burden of investing in water raises the question of sustainability in the long term. This will depend on the availability of investment resources from the central budget (and fiscal space to acquire additional debt) as well as on the incentives in place to ensure that NWSC uses these resources effectively.

Notes

More information on NWSC is available through its Web site (http://www.nwsc.co.ug).

1. Even though the trend shows a slight increase since 2006, nonrevenue water measured as water losses per connection has been declining every year, falling from 630 liters per connection a day in 2003 to 280 in 2008.

2. Quarterly workshops are organized to discuss findings and feedback with regional teams, and a scorecard is published to show relative performance and the incentive awards earned by staff and water utility managers in particular areas.

Reference

Muhairwe, William. 2009. *Making Public Enterprises Work—From Despair to Promise: A Turn Around Account.* London: IWA Publishing.

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