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Key Topics in Public Water Utility Reform

Urban water supply services have traditionally been provided by state-owned, water utilities. In the past decades, many governments have tried to turn state-owned water utilities into effective and viable organizations—with mixed success. Why have some public utilities become more efficient service providers, while others have not been able to break the vicious cycle of low performance and low cost recovery? The World Bank report “Key Topics in Public Water Utility Reform” presents a framework of attributes of well functioning utilities and how they have introduced key institutional measures. It thus aims to help water and sanitation sector practitioners to choose and apply public utility reform approaches.

Attributes

There is no perfect model for public utilities that guarantees good performance. But well-functioning utilities share common attributes:

- **autonomy** – being independent to manage professionally without arbitrary interference by others.
- **accountability** – being answerable to other parties for policy decisions, for the use of resources, and for performance.
- **consumer orientation** – Reporting and “listening” to clients, and working to better meet their needs.

These attributes apply to the relationship between the utility and the environment in which it operates as well as to the internal functioning of the utility.

The tools to achieve these attributes vary, but certain patterns of high potential practices are emerging. Institutional measures to make public utilities more effective include corporatization, public-public performance agreements, consumer accountability tools, and capacity building.

Corporatization

Corporatization transforms a utility into a public organization with its own corporate identity and independent status, with a board of directors. This can be either a statutory body functioning under public law or a government owned company incorporated under company law. In both cases ownership remains public. Results of corporatization are mixed, but corporatized utilities generally outperform departments within a ministry or municipality. The effectiveness of corporatization is determined by how some critical factors are legislated, and how consistently this legislation is adhered to.

The board of directors acts as a buffer and a bridge between utility management and its owners, the municipality. The composition of the board and its mandate must be well defined and insulated against political capture. This can be achieved, for example, through the use of fixed and staggered terms and transparent criteria and procedures for board appointments.

Asset ownership increases the autonomy of corporatized utilities, as investment planning is undisputedly their responsibility and managers have

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incentives to invest wisely and to increase the value of the company. Corporatized utilities use owned assets as debt collateral, rather than relying on implicit state guarantees.

Accounting and auditing standards are, or should be, as rigorous as those used in private companies. Some statutory bodies and government-owned companies are exempt from government regulations on personnel and procurement.

Governments can be better owners by explicitly prioritizing objectives and financing all mandates and by clearly defining who within the public administration will carry out the ownership function and how. In some countries and cities, the ownership role is centralized in a unit that holds state-owned enterprises in more than one sector. In others, a line ministry is responsible for ownership.

Diversifying ownership can reduce the risk that the government, as sole owner, may try to bypass the corporate oversight board. The São Paulo State Government holds just over half of the shares of its water utility (SABESP), with 49.7 percent in the hands of private stockholders. Alternatively, the municipality can sell or donate some shares to customers. Such efforts give consumers a stronger voice, as in the case of Aguas de Puerto Cortés in Honduras. Aggregating utilities in several geographical areas is another way of diversifying ownership. The board balances the needs of the various member municipalities.

Performance agreements

Public utilities are often confronted with a range of objectives to consider—without clear guidance on how to prioritize them. Public–public performance agreements can clarify the utility’s objectives and priorities. Agreements can prompt parties to focus on results and strengthen the relationship between parties by giving them periodic opportunities to discuss progress and problems. The process of introducing, updating and monitoring an agreement is at least as important as the longer term accountability through formal enforcement.

A contract plan is a negotiated agreement between a government—acting as the owner of a utility—and the utility that specifies the performance to be produced in a certain period of time. Con-

tract plans are binding and thus—in principle—enforceable by law. They are somewhat similar to private sector participation contracts.

In the past decade, some governments have managed to change the use of their financing by making their transfers conditional on the milestones in reform or performance of local governments of utilities. Other agreements range from short-term business plans and staff contracts to intergovernmental transfer systems. Business plans are short term agreements—often focusing on the next year, but within a longer term framework. Within the utility there are also opportunities to establish an incentive framework for the performance of managers and staff. This requires a robust performance evaluation system.

Performance agreements should be instituted gradually, as part of a wider set of reforms. Formal agreements that include sanctions should be held back until performance evaluation systems are functioning properly. Another success factor is autonomy, or “room to deliver.” Performance agreements can improve performance only if utilities have the discretion to improve the efficiency and effectiveness of their operations. For instance, the Government of Uganda provided considerable autonomy to the National Water and Sewerage Corporation before introducing a performance contract with the national utility. NWSC’s debt service obligations were suspended in return for a commitment to the operational and financial improvements in the contract.

Good contract design and effective implementation round out our success factors. In some countries, careful contract design has prevented many of the problems observed in the past. A good agreement is simple and short and outlines the responsibilities of each party, including performance targets and measurable indicators for third-party evaluations. Unfortunately, there has been little effort to develop standard contract clauses for public–public agreements.

Close monitoring using good data is the best way to guard against poor implementation of contracts. For instance, the performance contract between the government of Burkina Faso and its national utility ONEA includes 34 technical, financial, and commercial indicators, which are periodically submitted to the review of an external auditor.

Consumer accountability

Giving consumers the right to hold utilities accountable can help balance the accountability framework of utilities and can help prevent political capture. For consumers to effectively participate in the WSS sector, they do not only need a mechanism to participate but also the knowledge and skills to use that mechanism effectively.

Reaching out to consumers is not benevolent per se. Consumer accountability mechanisms that work in one context may not be feasible or effective in another. The challenge is to choose a “suite” of tools to ensure that all service users can engage with the utility or at least have their concerns and views heard and responded to. A well-functioning consumer accountability mechanism should be effective, inclusive, efficient and sustainable.

A first step in consumer participation is the provision of better information to individual consumers, communities and consumers at large. Information tools include publication of annual reports, information provided at service centers or with bills as well as structured outreach programs.

While information provision is a one-way process, consultation involves actively seeking and listening to users’ opinions. Surveys, if designed collaboratively for the purpose, can help utilities to understand and respond to users’ preferences as well as to chart their performance. Many companies use customer surveys, focus groups or customer interviews, and feedback forms or suggestion boxes, but too few actually apply the data to concrete efforts to improve service.

In the case of formal participation, utilities oblige themselves to take into account consumers’ views in the process and content of policy-making. Tools include giving consumer representatives formal voting rights on utility oversight board or regulatory committees. Involving in service provision, by fixing leaks for instance, can be a way of ensuring accountability as well as simply getting the job done. Consumer participation at the community level has a strong track record in areas where a tradition of communal organization and collective action exists. An example of this is the PROSANEAR program in Brazil that has provided a million poor people with piped water supply and sanitation.

A service provider can only be considered to be fully accountable if users have some way of calling them to account (recourse) and then, if justified, to obtain an appropriate response (redress). Mechanisms can be internal to the service provider, or external such as public service ombudsmen.

Capacity building

Capacity building imparts needed knowledge and skills to redress the skill shortages in government agencies and utilities that prevent decisions from being translated into action. Capacity building programs are more successful when they respond to demands expressed by those to be trained and go hand in hand with measures to motivate staff to implement their newly acquired skills.

Traditionally training programs focused on formal training for personnel before they start their career. However, policy, legal and institutional reforms require staff to gain new skills during their career. Often these skills can best be learned from other practitioners. However, training and knowledge institutions still have an important role to match supply and demand and to develop standard tools and materials for public utility reform.

Probably the most common and arguably the most effective way of training is through working with colleagues on the job. While on the job training is an implicit capacity building tool in many organizations, its use can be optimized by supporting and rewarding them for investing time into mentoring and transferring knowledge. SANASA, in Campinas, Brazil, uses staff working groups to develop personnel, gradually providing them more responsibility and training.

New professional networks generated in this way are powerful tools of capacity development. Using new technologies, partnerships between people and institutions across the world can take place directly without formal intermediaries.

In recent years, a new generation of contracts and agreements are emerging which blur the lines between private sector participation and public-public twinning arrangements. They increasingly focus more on transfer of know-how.

Sometimes municipalities need ongoing professional support for non-routine operations including

securing external financing. After Estonia's national WSS utility was liquidated in 1995, a new company, owned by the municipalities, was established to provide municipal utilities with technical support. The company developed expertise in project management, network rehabilitation, and feasibility studies.

The process of improving and institutionalizing performance

Improving performance will require implementing a coherent reform program which is tailored to meet the specific needs of a city or a country. Reform involves an interaction between the utility and the institutional environment in which it operates. The reforms that can be undertaken by a utility depend on the opportunities available in the institutional environment in which it operates. Similarly, improvements in the institutional environment in which the utility operates, are likely to have only a limited impact if the utility has insufficient internal capacity to make the most of this (beneficial) situation.

Reform programs usually begin when utility performance is declining and some specific event focuses attention on the poor service and creates the momentum for change. Once reform is triggered by a crisis, it is an incremental process. Utility reform measures are interdependent. While many reform measures should progress at the same time, circumstances seldom allow this. There may however, be critical paths in that some reforms are prerequisites for others. A typical reform process features three main stages; crisis management, recovery & stabilization, and expansion. After these three stages, a period of maintaining progress follows.

Phnom Penh Water Supply Authority in Cambodia went through these various stages. Firstly, the utility was restructured to become a government owned company and a new management team was recruited with performance based remuneration. Secondly, customer surveys, automated billing, meters and innovative technology to reduce leakage were introduced. A management system and a new

tariff structure followed. Only after these reforms accompanied by capacity building, was the utility able to expand its networks into poorer areas.

From best fit to best practice

Structural trends have altered the landscape in which water utilities operate. The transition of most utilities in the 1990s was not from public to private ownership or management, but from centralized to decentralized public provision. In the 1990s a drop in public budgets significantly reduced opportunities for network expansion and performance improvement. Under budgetary pressure, many public institutions have adopted new management tools, often borrowed from the private sector, to complement more traditional bureaucratic tools. Many countries have democratized, and an emerging civil society—including a consumer movement—has put pressure to deliver better services.

Public sector reform combined with sufficient investment in infrastructure can contribute to cost effective, reliable and safe water supply and improved sanitation. It is not a quick fix but a long process of limited, but sufficient institutional changes. Reformers may have to put up with less-than-ideal solutions in the short term. Selection of reform measures may have to be based on the best fit rather than the best practice. A closer look at both successful and failed reform process shows that what counts is not so much what measures are chosen, but in how far and how they are implemented. Reforms need to start with what can be done in practice. Many reforms have failed because their goals were too ambitious or not matched by the appropriate resources.

Reform processes include technocratic measures but are dialectic in nature. Change requires incremental steps—building managerial capacity, raising confidence, and accumulating experience. By building a coalition for change, and by creating and locking up quick wins, meaningful reforms can be implemented within one political cycle, even after decades of neglect.

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