



USAID
FROM THE AMERICAN PEOPLE

GOOD PRACTICES IN PUBLIC WATER UTILITY CORPORATIZATION

November 2006



THE OUTPUT

- Providing USAID missions and clients with guidance on corporatization approaches and tools to help improve utility performance.
- A PowerPoint presentation summarizes the principles and mechanisms associated with successful corporatization.
- The presentation is informed by Case Studies of utilities who have undergone corporatization and appear to be on a path to sustainable improvement.
- Documents were collected which served as instruments in structuring the specific corporatization and might be tailored by other countries engaging in corporatization.
- The presentation and the sample documents are available on a CD.





METHODOLOGY

The Case Study utilities are:

- Aqaba, Jordan;
- AQUA, Poland;
- Copasa, Brazil;
- Johannesburg Water, South Africa;
- National Water and Sewerage Company, Uganda;
- Public Utility Board, Singapore; and
- Sydney Water, Australia.





DEFINITION AND PRINCIPLES OF CORPORATIZATION



DEFINITION OF CORPORATIZATION

Corporatization is a process by which a public sector service provider is transformed to one with the commercial orientation of a private company. The transformation would typically include three ring-fencing activities:

1. Establishment of a distinct legal identify for the company under which the government's role is clearly identified as owner;
2. Segregation of the company's assets, finances, and operations from other government operations; and
3. Development of a commercial orientation and managerial independence while remaining accountable to the government or electorate.





KEY PRINCIPLE OF CORPORATIZATION

The guiding principle of corporatization is the intent to capture the advantages of a privately run company — including efficiency, productivity, and financial sustainability— while retaining government accountability.

A successfully corporatized company will be able to demonstrate positive or improved performance results.

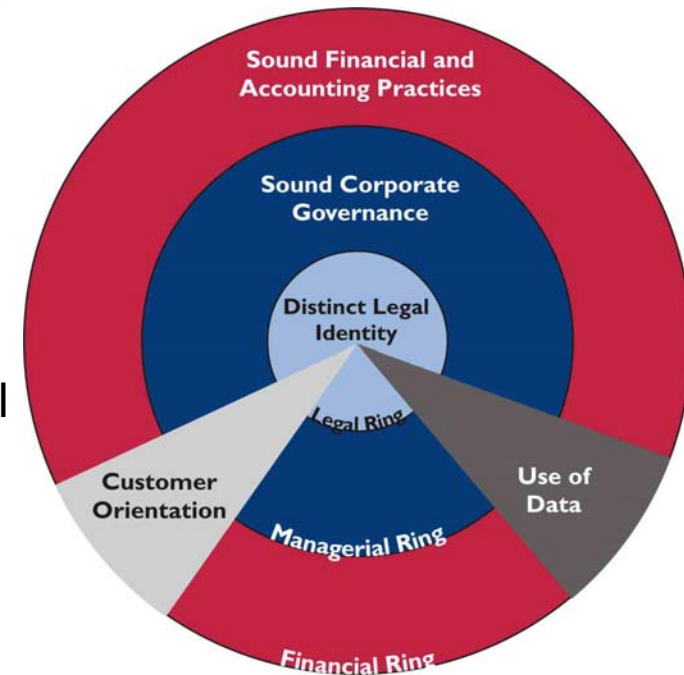




KEY CHARACTERISTICS AND MECHANISMS OF CORPORATIZATION

KEY CHARACTERISTICS OF CORPORATIZATION

- In order to capture the advantages of a private company, a corporatized company has to emulate the behavior of a private company.
- It does this by adopting 5 key corporate characteristics:
 - Sound corporate governance;
 - Separate legal entity or company at least partially owned by government (often local government);
 - Modern financial management and accounting practices;
 - Customer orientation; and
 - Effective and transparent use of data to assess and monitor performance.

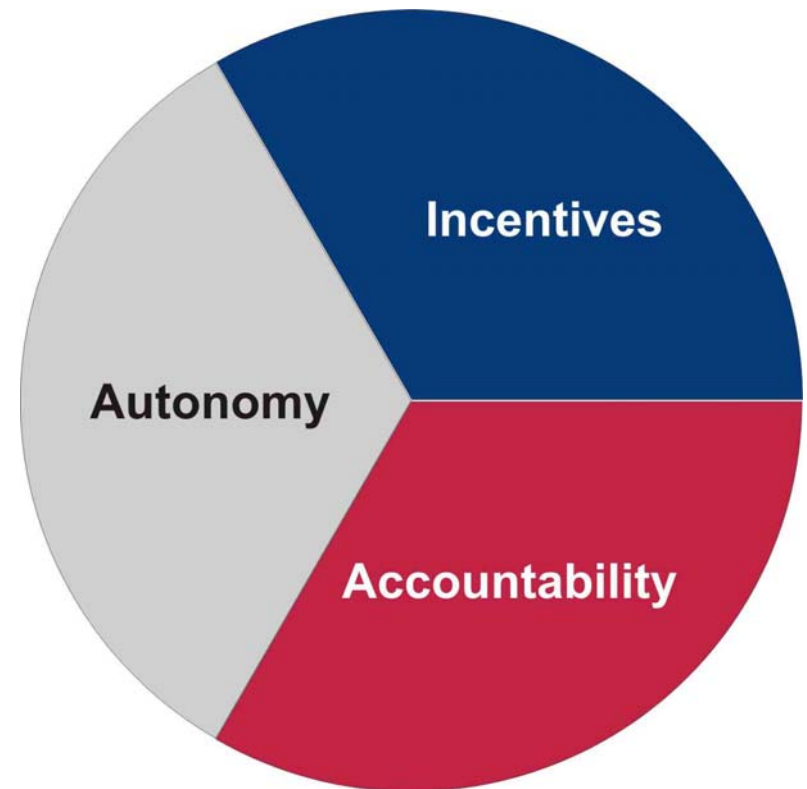


These characteristics are interwoven and mutually supporting.

KEY CHARACTERISTICS OF CORPORATIZATION

Each characteristic should be designed to ensure a balance of:

- **Autonomy.** Each characteristic has to be designed to give the utility the autonomy to make sound corporate decisions.
- **Incentives.** The characteristics should be reinforced by a system of targets and incentives.
- **Accountability.** The company should be externally accountable for achievement against each of the characteristics.



Framework of a Corporatized Company

KEY CHARACTERISTIC

CORPORATE GOVERNANCE

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CORPORATE GOVERNANCE

Corporate governance is the core of corporatization. It is the model of governance chosen to emulate a private corporation.

- A **governance model** refers to allocation of performance obligations among stakeholders and a related allocation of monitoring and enforcement obligations.
- The model makes transparent the **objectives, rules, and procedures** by which all stakeholders will engage with the utility.
- **Business tools** and mechanisms are used within the company to achieve, monitor, and enforce commercially oriented performance.
- A **fundamental goal of corporate governance** is to protect and enhance the long-term value of the company for the shareholders (government and others). This means increasing sales, controlling costs, and increasing revenues.





CORPORATE GOVERNANCE

A Corporate Governance regime is implemented at three levels:

1. At a national level – establishing the commitment to corporate governance;
2. At the level of owner/company – establishing the relationship between the utility and its owners; and
3. At the company level – establishing the:
 - The Board, with associated powers and capacity;
 - The motivation and ability of staff to fulfill the Board's vision; and
 - The company's integrity among consumers, the general public, and investors.



CORPORATE GOVERNANCE

Mechanisms and Examples

Level 1: The National Commitment

This commitment might take the form of a policy statement, a strategic framework for state-owned enterprises or a sector reform strategy statement. The statement makes transparent the government's intention to conform to its specified role and to delegate responsibilities to the level appropriate to the governance framework.

- **Australia** implemented the **Strategic Water Reform Framework** (1994) which set out long-term goals for economic and environmental sustainability including pricing reform based on consumption-based pricing and full-cost recovery, the reduction or elimination of cross-subsidies, and making subsidies transparent.



CORPORATE GOVERNANCE

Mechanisms and Examples

Level 2: Relationship between Owners and Utility

- The relationship between the owners and utility is established by a contractual document(s) such as a license, a performance agreement or a shareholders agreement.
- The type of contract is influenced by the ownership structure, the legal environment, and local precedent.
- The document typically contains the agreed obligations of each party, the reporting and monitoring requirements, and any incentives or penalties.
- The document helps establish the channels of accountability and the degree of autonomy.



CORPORATE GOVERNANCE

Mechanisms and Examples

Level 2: Relationship between Owners and Utility

The contract(s) reiterates the higher level commitment to commercial sustainability

- **Sydney Water** is governed by an **Operating License** requiring Sydney Water to:
be a successful business and to this end operate at least as efficiently as any comparable business (and) maximise the net worth of the State's investment in Sydney Water....
- **Sydney Water's Board** must prepare a **Statement of Corporate Intent** (SCI) with commercial performance targets agreed between Sydney Water and shareholders. Sydney Water's revenue, operational and capital budgets form the basis of these targets.

Penalties are set out....

- The Sydney Water Act includes guidance on the **enforcement of the operating license** including authority for the regulator to require remedial action, imposition of monetary sanctions and even termination of the license





CORPORATE GOVERNANCE

Mechanisms and Examples

Level 3: Internal to the Company

An Independent Board is one which is able to act independently from the controlling shareholder and to act in the best interest of ensuring the long term sustainability and value of the company.



CORPORATE GOVERNANCE

Mechanisms and Examples

Level 3: Internal to the Company

Different degrees of independence....

- **AQUA** has a two-tier board with Supervisory Board and Management Board. Supervisory Board has 3 appointed by municipality (51% owner) and 2 by strategic partner (33%). The **Warsaw Stock Exchange Best Practices Code 2005** calls for at least two directors to be independent.
- **Sydney Water's** Board of Directors are appointed by the Shareholder Ministers. **Advertising for nominations to the Board is a requirement under the Sydney Water Act 1994.**
- The **NWSC** Board of Directors has 9 members, including Director of Directorate of Water Development. The Board is **appointed by the Minister** of Water, Lands and Environment. In appointing the Board of Directors, the Minister selects people with **specified expertise.**
- The **Aqaba Water Company** has a Board of 7 members—5 members from Ministry of Water and Irrigation/Water Authority of Jordan (85%), and 2 members from **Aqaba Special Economic Zone** (15%).



CORPORATE GOVERNANCE

Mechanisms and Examples

Level 3: Internal to the Company

Board and management have appropriate guidance on designated roles...

- The Board of **Sydney Water** has adopted a **Code of Conduct** based on Principles developed by the Australian Institute of Company Directors.
- The **NWSC** Board of Director's functions and responsibilities are set out in the **National Water and Sewerage Corporation Act 2000**
- **The Polish Institute of Directors** has developed **training courses for directors of listed companies** and helped develop the Best Practices Code.

CORPORATE GOVERNANCE

Mechanisms and Examples

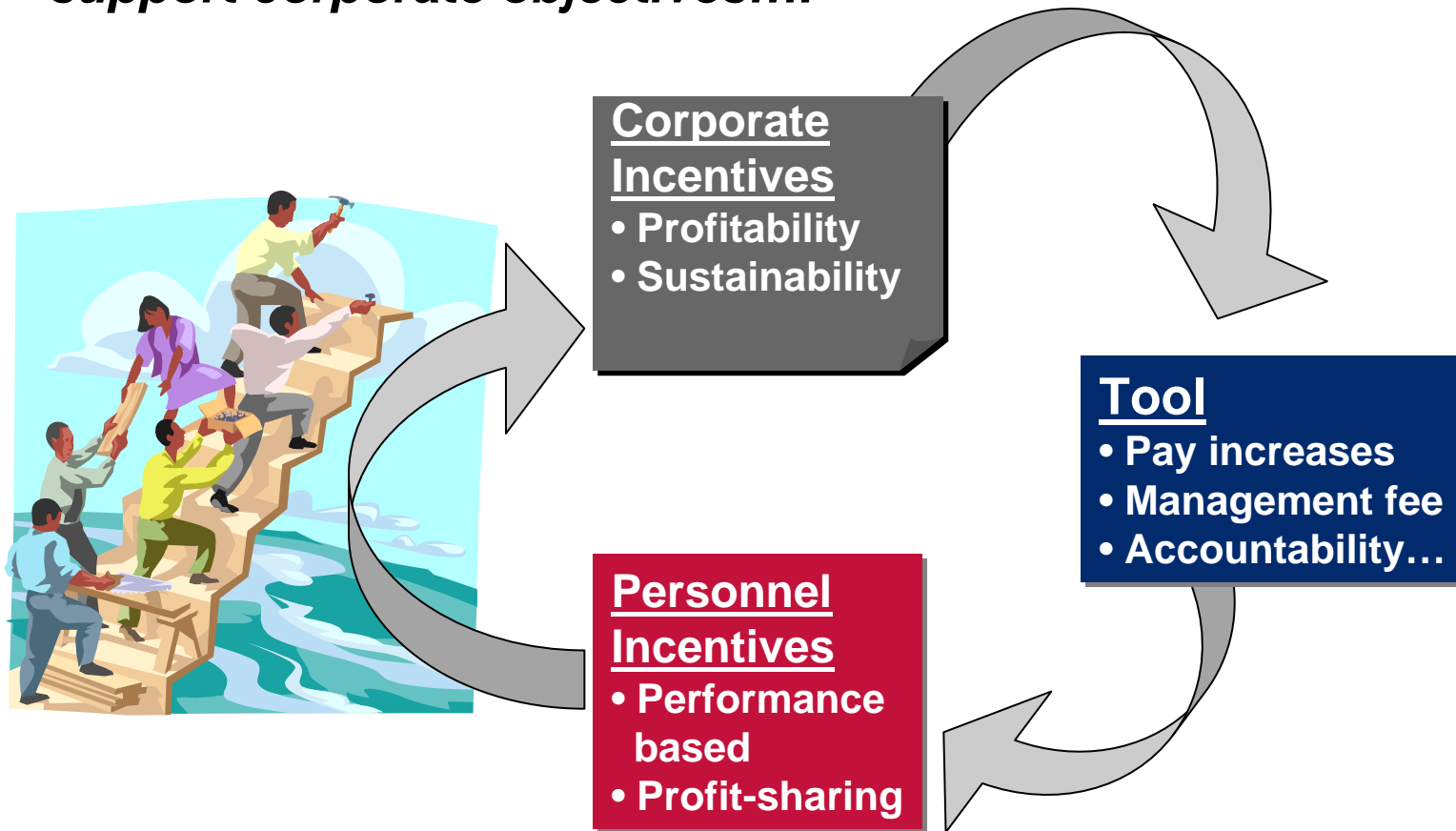
There is an established system of personnel incentives to support corporate objectives....

- In 2004, **Singapore's Public Utility Board** moved from tenure-based fixed incremental pay increases to a system of **performance-based merit increases**. The system was introduced first to executives and then negotiated with the PUB Employees' Union.
- In **Uganda**, key staff members of the regional utilities are paid a management fee including a Fixed Fee (100 % of uncontrollable and 75 % of controllable monthly costs), **Performance Fee** (25 % of controllable costs provided all minimum performance standards are met), and **Incentive Fee** (extra payments for exceeding minimum performance standards)
- **Sydney Water's** Managing Director is accountable to the Board through an Instrument of Conferral of Powers and Authority granted by the Board, an **Employment Agreement**, and a **Performance Agreement**. Performance of the Managing Director is reviewed every six months.

CORPORATE GOVERNANCE

Mechanisms and Examples

There is an established system of personnel incentives to support corporate objectives....





CORPORATE GOVERNANCE

Mechanisms and Examples

The operations and performance of the Board and company are transparent to the public, fostering a reputation of integrity...

- The websites typically contain the Annual Reports, guiding legislation and regulation, biographical details on Board members and often minutes of meetings.
- Annual Reports typically detail performance against Corporate Plan or indicators, financial performance, and highlight shortcomings.
- Some countries choose to televise their Board meetings or the Board appointment interviews.
- Open advertisement of the Board positions provides transparency in the identification of candidates.

CORPORATE GOVERNANCE

Common to the effective corporate governance structures are....

- Defined and transparent mechanisms to set expectations and monitor performance
- Non discrimination against any group of shareholder
- Vesting the appropriate authority in the company and its Board
- Creating confidence and sustainability through transparency, documentation, and training
- Alignment of individual incentives with corporate incentives and owner incentives
- Clear channels for reporting and accountability



KEY CHARACTERISTIC

LEGAL STRUCTURE

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LEGAL STRUCTURE

Importance to Corporatization

- The legal transformation to a corporate entity changes the relationship of the government to the utility, giving government a clear role as owner.
- Under a corporatized legal structure, the corporate board has defined interests or priorities in relation to the company.
- In most cases, the legal regime for a corporatized utility provides a more rigorous system of performance expectations and oversight than the system within which a government department operates.
- Typically, the legal regime for a corporatized utility provides a greater degree of organizational autonomy.



LEGAL STRUCTURE

Mechanisms and Examples

Different legal and ownership structures are possible....

- **Aqaba Water Company** is a **limited liability company** formed under the Companies Law.
- **AQUA** is a **Joint Stock Company**. It is incorporated and operates under the Code of Commercial Partnerships and Companies 2001.
- **COPASA** is a mixed **public-private corporation** owned by the State (Minas Gerais, 60%), the largest city (30%), a market float (10%), and other shareholders (-1%). It was established under State company law.

Companies governed by private corporate law and operating as private sector corporations in which government is a shareholder



LEGAL STRUCTURE

Mechanisms and Examples

Different legal and ownership structures are possible....

- **Johannesburg Water** is a **Limited Liability Company** spun off from local government in 2001 under the Local Government Affairs Act. The City of Johannesburg is the sole shareholder.
- **NWSC** is a government parastatal, or “**autonomous water board**”, wholly owned by the Government of Uganda. Its responsibilities are set out in the Water Statute 1995.
- **PUB** is a **statutory board** under the Singapore Ministry of the Environment and Water Resources established under the Public Utilities Act 2001 (PU Act).
- **Sydney Water** is a **state-owned corporation** owned by the people of New South Wales, Australia. The corporation has two shareholding ministers—the Minister for Infrastructure and the Minister for Finance and Commerce. The guiding legislation is the State-Owned Corporations Act of 1989 and Sydney Water Act of 1994.

Government-owned corporations are regulated by public enterprise laws, and in the case of statutory bodies, they are defined as public corporations by virtue of the law that created them.



LEGAL STRUCTURE

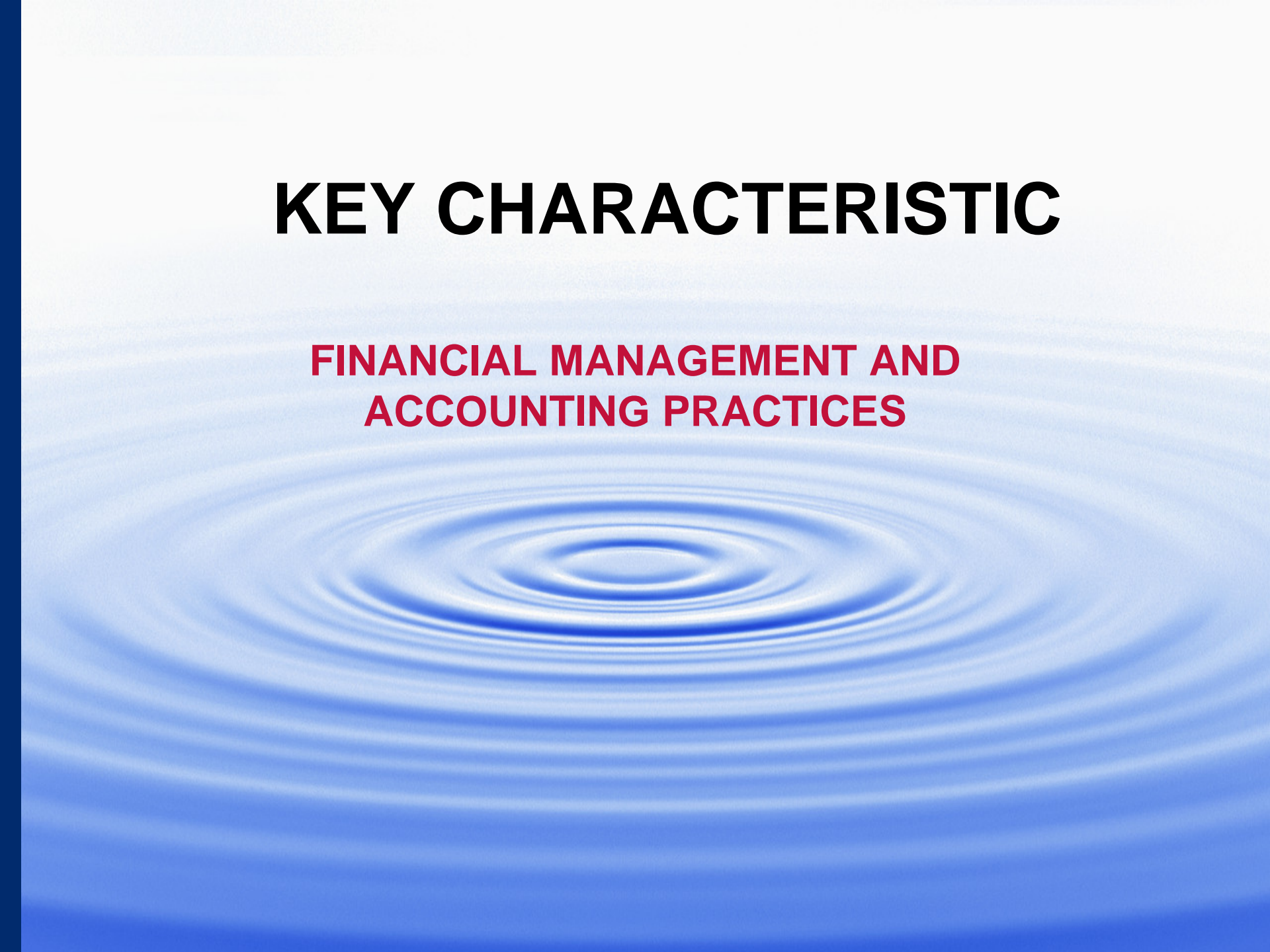
Common to the effective legal structures are....

- A legal framework comparable to that of non-government owned commercial companies,
- Provision for Boards of Directors,
- Clarity of corporate objectives,
- Transparency of obligations of each party,
- Requirement for commercial orientation,
- External accountability, and
- Documented targets and performance expectations.



KEY CHARACTERISTIC

**FINANCIAL MANAGEMENT AND
ACCOUNTING PRACTICES**



FINANCIAL MANAGEMENT AND ACCOUNTING

Relevance to Corporatization

Within a corporatized utility, it is more likely that:

- The utility has a documented and demonstrated commitment to achieving financial sustainability.
- The utility sees customer revenue generated through core services as a key source of financing and treats consumers and customer accounts accordingly.
- The utility has defined goals to recover, at least, O&M and possibly investment costs, depreciation, and debt service.
- The service goals are established with consideration of the financial resources available to the utility (including customer revenue, loans, and government subsidies). There is no financing gap.
- There are channels to ensure that the tariff setting and approval process is appropriate to the overall business, investment, and financing plans.



FINANCIAL MANAGEMENT AND ACCOUNTING

Mechanisms and Examples

There is a commitment to long-term financial sustainability...

- A Memorandum of Understanding between the Government of Uganda (GoU) and the **NWSC** identifies the “...perpetual accumulation of **arrears by Government of Uganda** Ministries...as a threat to both the smooth operations and financial viability of NWSC.... The Memorandum sets out a process for GOU to resolve current arrears and prevent accumulation of future arrears.
- According to its Performance Agreement with municipal government, **AQUA** commits to financial viability in order to implement investments. The Agreement includes projections of the **financial position required for financial viability** and the annual financial performance indicators which AQUA must attain to maintain. AQUA commits to maintaining these indicators through revenue increases/expenditure decreases



FINANCIAL MANAGEMENT AND ACCOUNTING

Mechanisms and Examples

A corporatized utility values customers as a source of revenue...

- The Water Herald, the **NWSC** Newsletter, states:
By keeping customers happy, they can increase sales and profitability for the business. This will also lead to both the acquisition of new customers as well as the retention of the old ones. Any change in service delivery should always bear a customer focus because “The Customer is the Reason we exist.”
- **COPASA** states as part of its strategy an intent to:
...continue to enhance the quality of the Company's services and operating procedures, operating in a safe, expeditious and efficient way in meeting the needs of the Company's customers and by offering new products and services. COPASA believes that by operating in this way COPASA can help to ensure the satisfaction and the loyalty of the Company's customer base.



FINANCIAL MANAGEMENT AND ACCOUNTING

Mechanisms and Examples

The utility has defined goals for cost recovery linked with service goals and financing sources...

- **NWSC Performance Contract** with the Government:
 - The level of tariffs must in the long run cover the total costs of NWSC and must provide a return on the assets employed in the business.
 - In the long term the tariffs must be sufficient for rehabilitation, on-going maintenance and eventual replacement of aging assets, and to provide a partial self-financing component for future investments.
 - Tariff policy should minimise cross-subsidization between customer classes.
- In **Johannesburg**, the municipal government publishes a **Service Delivery and Budget Implementation Plan** which explicitly links service targets for the coming year with sources of financing

FINANCIAL MANAGEMENT AND ACCOUNTING

Mechanisms and Examples

Financial information is proactively collected, analyzed and used...

- With the admission of **COPASA** to the *Novo Mercado* of the São Paulo Stock Exchange is subject to the provisions of the Listing Rules. COPASA operates a **Financial Accounting System**, following a transition and training program of its finance staff. The FAS system generates necessary financial reports in accordance with international accounting standards. The FAS will help management to develop financial indicators for benchmarking and performance measurement.
- Aqaba Water has a newly implemented **finance and accrual-based accounting system** based on Oracle® e-business will allow managers to keep track of the daily operations of the company with accurate estimations and a transparent way to handle the finances. The new system will allow AWC determine precise costs so subsidized activities will clearly be identified.



FINANCIAL MANAGEMENT AND ACCOUNTING

Mechanisms and Examples

Laws and regulations specify the financial and accounting practices to be implemented...

- The Public Finance and Audit Act of New South Wales further requires that the financial report should be in accordance with **Australian Accounting Standards** and according to other statutory requirements.
- The Municipal Finance Management Act of South Africa requires the City of Johannesburg to appoint an **Audit Committee** for **Johannesburg Water**.
- **Aqaba Water** is now independently audited in accordance with **International Standards on Auditing**.
- **NWSC** produces an Annual Report, and the NWSC accounts are audited by an **External Auditor** appointed by the Auditor General. The Annual Report, Audited Accounts and Auditor's Report are forwarded to the Minister and Parliament for review and further action if necessary



FINANCIAL MANAGEMENT AND ACCOUNTING

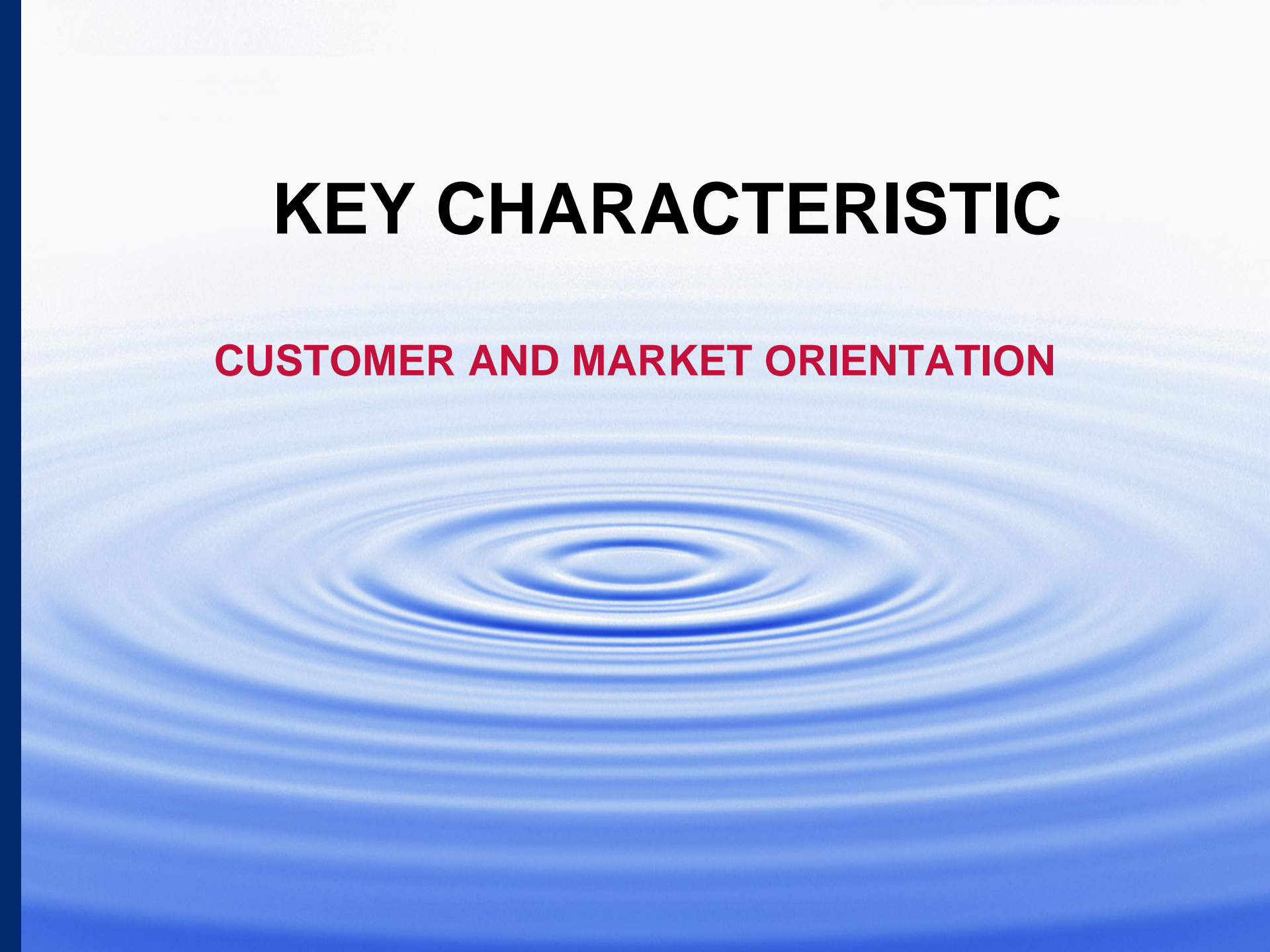
Common to the effective financial management and accounting mechanisms are....

- Clear financial targets and policies related to cost recovery, profitability, dividends, subsidies and other performance indicators.
- An adequate financial reporting system and trained staff
- Internal financial controls through the Board and external (independent) audit, including potential for special audits
- Publicly available financial information complying with international standards
- A willingness to evaluate financial results of the corporatized company in the same way a private company would be evaluated



KEY CHARACTERISTIC

CUSTOMER AND MARKET ORIENTATION



CUSTOMER AND MARKET ORIENTATION

Relevance to Corporatization

Within a corporatized utility, it is more likely that:

- There is a formal contract with customers or statement of its service obligations to customers.
- Techniques and mechanisms are developed to encourage and facilitate bill paying and customer outreach.
- Customer satisfaction is measured and evaluated. Satisfaction is seen as important to maintaining a positive revenue stream even when there is limited competition.



CUSTOMER AND MARKET ORIENTATION

Mechanisms and Examples

Customer Contracts set out the respective obligations...

- The rights and duties of **AQUA's** customers are set out in the operating permit. A customer can receive **compensation for services below the agreed standards.**
- The Operating License for **Sydney Water** includes Schedules for Customer Service and the Customer Charter. The **Customer Contract** sets out the rights and obligations of customers and Sydney Water.

Customer outreach is encouraged...

- **Sydney Water** makes use of a **customer council.** The council membership must include:
 - Business and consumer groups,
 - Low-income households,
 - People living in rural and urban fringe areas,
 - Residential consumers,
 - Environmental groups,
 - Local government, and
 - The Ethnic Communities Council.



CUSTOMER AND MARKET ORIENTATION

Mechanisms and Examples

Customer satisfaction is measured and assessed....

- The **PUB C.A.R.E model** structures the interaction between PUB and its customers. When feedback is received (CALL), immediate action (ACTION) should be taken by recording and/or forwarding it to relevant department for follow-up (RESPONSE). Feedback must be monitored and tracked. The department evaluates (EVALUATE) the causes and takes measures to prevent recurrence.
- The annual **Scorecard** of **Johannesburg Water's** performance issued by the City of Johannesburg includes reporting on responsiveness to customers.

CUSTOMER AND MARKET ORIENTATION

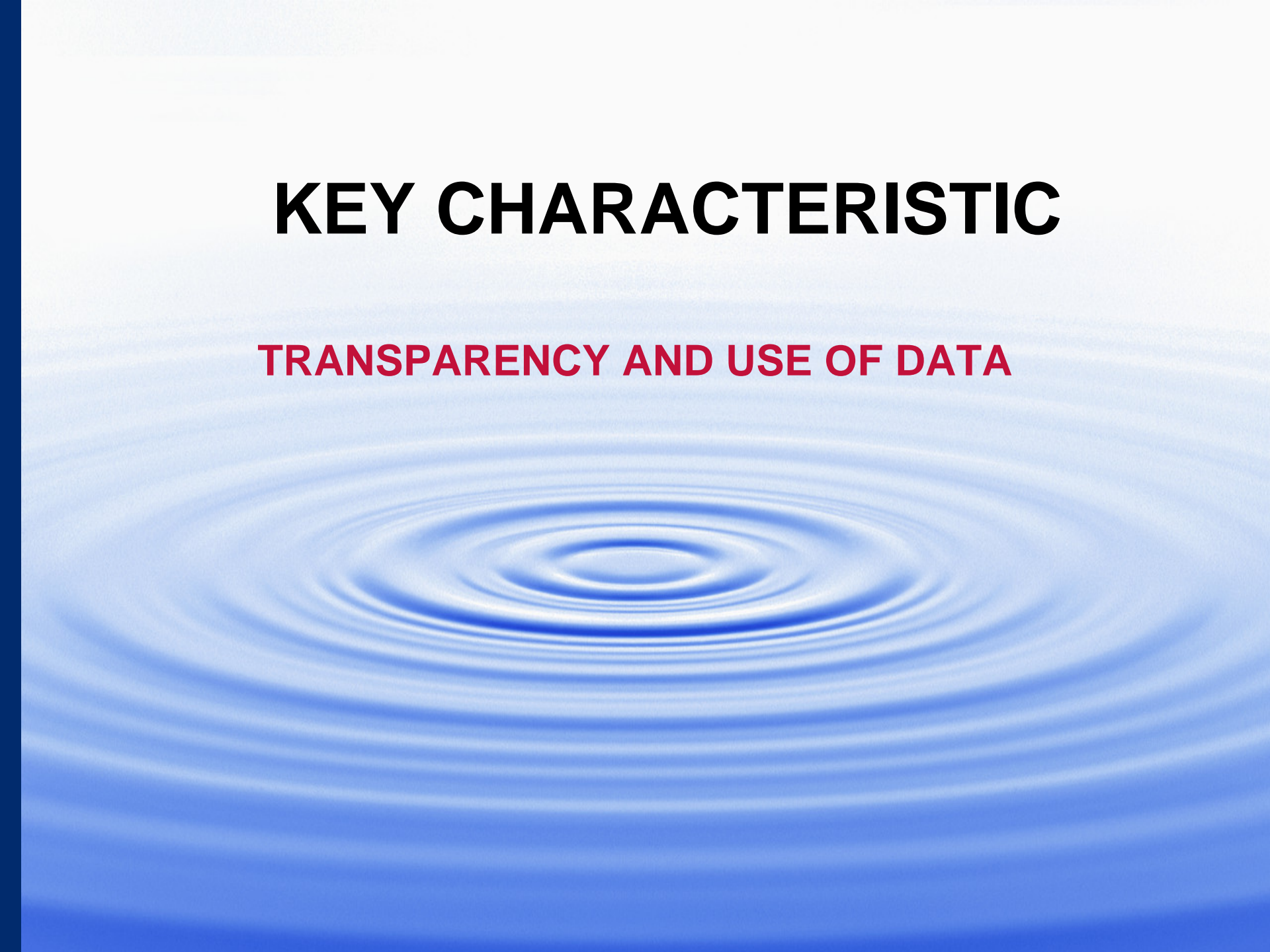
Common to the effective customer and market orientation are....

- Recognition of customer value as a source of revenue
- Consultation and communication with customer to establish demand responsive service
- Monitoring and reporting on clear targets for improving customer satisfaction
- Transparent commitment to the customer through a customer contract or charter and through actions



KEY CHARACTERISTIC

TRANSPARENCY AND USE OF DATA



TRANSPARENCY AND USE OF DATA

Importance to Corporatization

- Transparent framework for setting and measuring achievement against government objectives establishes public credibility, confidence, and accountability.
- Information provided to oversight bodies allows for Board and management to be held accountable for results.
- Information flows within a company allow better management and targeted activity.
- Data can be used effectively to create a system of incentives linking personal goals (compensation) and corporate performance.



TRANSPARENCY AND USE OF DATA

Mechanisms and Examples

There is a transparent framework for measuring progress against government's objectives...

- The Municipal Finance Management Act of South Africa requires production of a **Balanced Scorecard** for **Johannesburg Water**. This Scorecard focuses on technical and financial results as against strategic priorities previously set out.
- The **Sydney Water** Act authorizes the Independent Pricing and Regulatory Tribunal to ensure that an **operational audit** is conducted annually against the operating license.
- The Research, Monitoring, and Evaluation Department of the **NWSC** collects and analyzes local performance data and develops a **benchmark reports**.



TRANSPARENCY AND USE OF DATA

Mechanisms and Examples

Financial and other information is made transparent and used for public assessment of performance...

- The city water managers of the six major cities of South Africa, including **Johannesburg Water**, recently created **a forum to collect data** on performance in key areas.
- A **qualified audit opinion** of **Johannesburg Water** related to the utility's lack of control over billing and the customer database, much of which was retained by the municipality. The qualified opinion galvanized an ongoing negotiation on the transfer of those responsibilities.
- **Sydney Water** provides a **Consumer Confidence Report** to each customer with its bill. The report details the quality and quantity of water available to and provided by the utility. The report is also available on the website and to the public free of charge.
- In Brazil, the **National Information System for WS&S** (SNIS) has been used since 1995 to collect data on the range of water and sanitation service providers. The federal government has started to use SNIS in order to help *prioritizing financing*.

TRANSPARENCY AND USE OF DATA

Common to a transparent and effective use of data are....

- Reporting regimes that require disclosure to stakeholders apart from those who directly own or oversee the company
- Reporting in an understandable form that allows for sector comparisons, comparison with other companies and comparison with previous time periods
- Reporting of financial and non-financial results
- Linkage of internal incentives with publicly reported results
- External confirmation of reporting results
- Integrating the collection and use of data into management processes

