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Using a Private Operator to Establish a Corporatized Public Water Utility

The Management Contract for Johannesburg Water

In post-apartheid Johannesburg, South Africa, the city water authority had fallen into disarray (a common situation with urban services). In 2001, a Public-Private Partnership (PPP) emerged as a way to bring new expertise and efficiency to the delivery of public utility services, where a five-year management contract successfully restored services, built local capacity, and helped put Johannesburg Water on a solid footing.

Management contracts for improving the performance of water utilities

Since the 1990s, many governments in the developing world have experimented with to public-private partnerships (PPPs) as a way to improve the quality and sustainability of their water supply and sanitation services. Different contractual schemes were used, with varying levels of risk and responsibility passed to the private partner. While concessions transferred the most responsibilities, management contracts stood at the lower end of the spectrum, involving a three- to five-year term, no private investment, and payment of the private partner through an annual fee based, in part, on performance.

As a lighter approach for private sector involvement, management contracts have been mostly used for situations where the deterioration of infrastructure and lack of reliable data was such that other PPP options were deemed too risky. As such, they were often introduced as a first step in the reform, before a second, wider-scope PPP contract could be implemented.

The management contract for water supply and sanitation services in Johannesburg, South Africa presents an entirely different perspective. The municipal government implemented the PPP as an interim measure, part of a program specifically designed to improve the efficiency of municipal public services.While an experienced international operator was brought in, the aim of the PPP was not to transfer management to a private concessionaire for the long run. Instead, the goal was to establish a viable, corporatized public water utility by leveraging the expertise of an experienced private operator for a number of years.

The Challenges and Opportunities in Johannesburg

The end of apartheid in South Africa ushered in enormous changes. The new metropolitan municipality of Johannesburg was created out of several former municipalities, and the full incorporation of the townships. This represented a major administrative reorganization, meaning in the case of the water and sanitation services combining multiple

This note reports key messages from "Using a Private Operator to Establish a Corporatized Public Water Utility" by Philippe Marin, Jean-Pierre Mas, and Ian Palmer, published by the World Bank in June 2009. It is part of a broader study aimed at assessing the overall performance of Public-Private Partnerships (PPPs) for urban water and sanitation utilities in developing countries. Readers may download the complete paper from www.worldbank.org.

departments operating without cohesion into one single utility company.

Creating such a utility was not easy. The fragmentation of responsibility within the municipality had created a bureaucratic culture with little accountability for results. Employee motivation was weak. Capital investment projects ran into ongoing delays and cost overruns, and operational problems of the sewerage system had become a growing environmental concern. Furthermore, the water and sanitation services were essentially bankrupt by 2000, and there was widespread frustration in the population with the poor quality of customer service.

Faced with these challenges, the new municipality decided to enlist private help to create a more business-oriented utility, named Johannesburg Water. This company would be owned completely by the city government, but fully corporatized and operating under private law. Moreover, it needed to be made financially viable without big tariff increases that the population would resist-meaning that significant operational efficiency gains had to be achieved.

After an international competitive tender, the five-year management contract was awarded to a consortium led by Suez, which initiated operations in early 2001 as Johannesburg Water Management (JOWAM). When the private operator left at the end of the contract (in June 2006) the water utility's management returned to public hands. This review confirmed that the management contract fully met its goal—to improve operational performance and establish a viable, corporatized public water utility. This positive experience suggest a new way of looking at management contracts—as auxiliary in a public sector reform—and should be useful to other developing countries looking for options to improve their water and sanitation services.

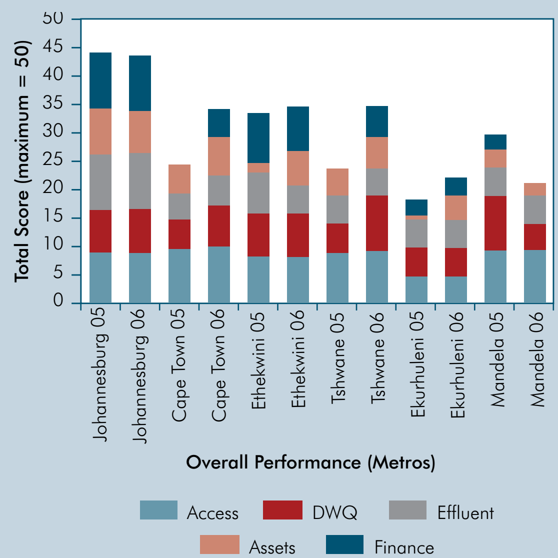
What was achieved under the management contract

An independent international consulting firm was recruited during the contract to collect reliable information on multiple performance indicators of JW. This allows carrying out an objective evaluation of the performance of the private operator under the management contract. The analysis shows that it's performance was satisfactory. The private operator achieved more than 90 percent compliance with contractual targets every year, with clear improvements in customer service, environmental compliance, bill collection and cost efficiency.

The private operator was also instrumental in carrying out a complete financial turnaround, in partnership with the city's authorities, restoring the utility to financial equilibrium by 2006 (see Figure 1). After being virtually bankrupt when the management contract had started, the municipal utility was back to financial heath in 2005, turning out a small profit. This was achieved without any employees layoffs. In the best illustration of its positive impact, the National Benchmarking Initiative ranked Johannesburg Water as the best metropolitan water and sanitation utility in the country in both 2005 and 2006.

Although, public-private partnerships in water have been controversial in South Africa, there is widespread agreement among stakeholders that Johannesburg Water benefited from the five-year management contract—a perception confirmed by all those interviewed as part of this study. Beyond improving performance, the foreign operator was also praised for facilitating the training and promo-

Figure 1. Benchmarking Results for Metropolitan Water Utilities in South Africa, 2005 and 2006



Source: SALGA, Department of Water Affairs, and Water Research Commission 2007.

tion of a large group of black managers and professionals, who were well equipped to run the utility by the end of the contract.

Why was the management contract in Johannesburg so successful?

Several aspects stand out in the design and implementation of this PPP:

- A high level of political commitment to the public-private partnership from the start. The municipal government was strongly committed to turning around the water and sanitation services. There was a strong ownership of the choice made to bring an experienced private operator to help for a few years under a management contract—a decision made entirely by the elected municipal government, without donors' conditionality for accessing external funding.
- The management contract in Johannesburg had a single clear objective—to establish a viable, corporatized public water utility with well-defined performance targets. *It was not designed as a catchall with multiple unrealistic targets.*
- The municipality was able to adopt a flexible approach to measuring the year-by-year impact of the private operator. Where a reliable baseline is lacking, assessment of an operator's performance becomes difficult, and this often leads to distrust and conflict. This issue was approached with notable pragmatism in Johannesburg. The contract's first year was dedicated to establishing a reliable baseline and performance monitoring system so that progress could be reliably measured, against increasingly stringent targets, in later years. This solution required both sufficient trust between the partners and the presence of a reputable independent auditor.
- Both partners were committed to success and worked well together. The private operator proved ready to devote substantial resources to making the contract work (probably in the hope of developing future contracts). Meanwhile, the city authorities didn't interfere in the utility's day-to-day management. They also appointed as JOWAM's counterparts competent executives who supported corporatization reform. The parties built a relationship of trust, essential for dealing with new developments during the contract.
- There was a strong focus on developing human resources. The private operator sent a large number of expatriates during the first year of the contract to ensure a rapid transfer of know-how, and a competent management team from the city was gradually trained and installed in positions of responsibility. The private operator also built ownership of the reform among the utility's employees so that they would actively support its efforts to improve performance. Much of the progress achieved was because the utility's employees were treated as assets and partners in the ongoing reform.

Other factors enhanced success: while the municipal water and sanitation departments were not functioning well at the start of the management contract, neither were they dysfunctional, as was often the case with management contracts implemented in other (and often less developed) countries. In addition, the infrastructure was generally in satisfactory condition. This allowed the private operator to focus on improving the management of staff and assets, and develop a new corporate vision of efficiency and customer orientation.

Looking forward: Using management contracts to help corporatize public utilities

The study focused on the performance of the management contract, and did not review the evolution of Johannesburg Water after the end of the contract and its transfer to public management in 2007. Maintaining the gains achieved by the management contract shall largely depend on the utility's ability to keep talented staff, and the city's continued ability to focus on financial viability while refraining from interference in operational management. This is always a challenge under direct public management.

The Johannesburg experience holds a major lesson for water practitioners. Public and private management of water utilities have commonly been viewed as two antagonistic approaches: a government's choice between keeping its water utility under public management or bringing in a private operator from outside to take over control. Experience in Johannesburg suggests that this is only a misperception and is largely unfounded: the PPP succeeded in establishing a viable, corporatized public utility. The private sector came in support—and not to replace—the public sector.

The clear strategic direction embedded in the contract, which reflected solid public policy choices by the municipal authorities, probably played a major role in ensuring collaboration from most stakeholders. This new approach for management contracts—as instruments to support public sector reforms instead of as a first step of the process of transferring to a private operator the provision of water and sanitation services—runs contrary to some accepted dogmas. Actually, it does not even matter whether the external partner is publicly or privately owned, as long as it is a competent operator and the management contract establishes clear objectives and fosters financial performance and accountability.

The Johannesburg experience is worth considering by governments that have made the strategic decision of corporatizing their water utility and keeping it under public management over the long term, but are not necessarily against leveraging outside help from a professional operator for a few years.

WATER PARTNERSHIP PROGRAM

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