

# PRIVATE BUSINESS, PUBLIC OWNERS

GOVERNMENT SHAREHOLDINGS IN WATER COMPANIES



SUMMARY

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IN WATER COMPANIES

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The Ministry of Housing, Spatial  
Planning and the Environment

Water Supply and Sanitation  
Collaborative Council

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# PUBLIC WATER PLCs COMBINE THE BEST OF BOTH WORLDS

The challenge facing many developing countries nowadays is how to supply sufficient water of good quality at a reasonable price. On the one hand, demand for water is rising exponentially due to continuing population growth and rising standards of living, while on the other hand, water supply companies frequently have to cope with water shortages or pollution of water resources. Furthermore, many water supply and sanitation systems are in a deplorable state due to insufficient upkeep.

There is a broad consensus about what should be done to respond to this challenge. While the objective of having sufficient water for all at an affordable price still holds, water should also be treated as a scarce commodity. Water has a price. This has consequences on two fronts: on the one hand, it means that customers should pay the full cost of service provision; on the other hand, the water supply utilities are obliged to keep their costs as low as possible by improving operational efficiency.

In many countries water supply is a public service controlled by the government. There is a lot to be said for this, even if it is only that good water supply and sanitation is in the public interest. The other side of the coin, however, is that government-operated utilities are not always a shining example of efficiency. In recent years privatisation of the water supply sector has therefore been the favoured option. Market forces must ensure that supply and demand are efficiently matched. Private business, however, has tended to focus on areas where demand is backed up by purchasing power. That means that there are still sections of the population who do not have access to affordable, good-quality water.

There is an alternative, however. The Netherlands can draw on almost 100 years of experience of working with an alternative mode of organisation that is a cross between a public-owned utility and a private company: the Public Water PLC (government-owned public limited company). Public Water PLCs are incorporated as private companies and are also subject to the rules and regulations governing commercial business. The majority of their shares, however, are owned by local or national government. These Public Water PLCs are relatively common in the water supply business. They can be found in Europe, as well as in North America, Asia and Africa. Yet they are still a relatively little-known phenomenon, largely because they are often confused with corporatised (parastatal) utilities. This is unfortunate, as a Public Water PLC is an interesting alternative for water supply in developing countries. In actual fact, the Public Water PLC combines the best of both worlds: public ownership married with operation according to commercial business principles.

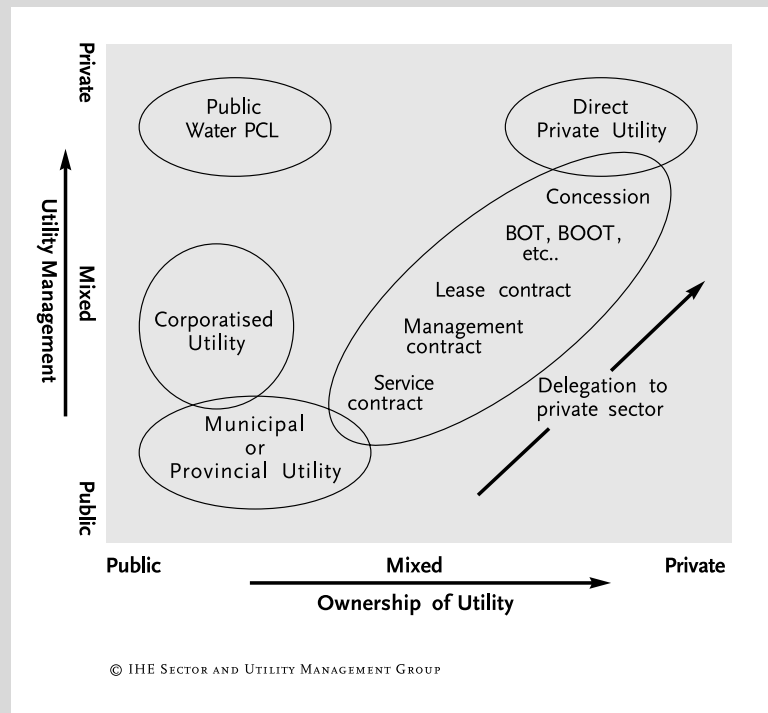
The combination offers all the necessary advantages. As a public limited company, it is required to provide optimum water supply services for everyone in its service area. The fact that it operates on a commercial basis means that the cost of services provided have to be recovered from the users. Another advantage, the importance of which can scarcely be underestimated, is the financial transparency of a Public Water PLC, which is required to open its annual accounts to public scrutiny. As a public limited company, it cannot conceal data in the annual figures of the holding company.

This booklet outlines the importance of and experience with Public Water PLCs in the water supply sector. It is primarily based on the situation in the Netherlands, where this type of construction dominates the water industry. A brief look is also taken at how Public Water PLCs operate in Poland, Chile and the Philippines. Despite the fact that these countries are very different, experience with this mode is predominantly positive in each case. Not only does the Public Water PLC appear to work fairly efficiently, the quality of the service is also excellent. This makes the Public Water PLC an attractive organisational mode for the water supply sector.

# A TAXONOMY OF ORGANISATIONAL MODES

This figure presents five basic modes of water supply sector organisation. Each of these modes has been arranged along two axes. The Y axis represents the degree to which the utility is under public or private management. The X-axis represents the degree to which the utility's assets are in public or private hands. Both axes range from public through mixed to private.

Basic Modes of Water Sector Organisation



Bottom left we find the archetypal type of water supply utility: owned and managed by the local or provincial government. This is also the most common variant.

Following the Y-axis upwards, we find the public utility with a special status (parastatal). This type of corporatised utility operates autonomously from the government, while retaining its links with the public sector.

On the right-hand side of the figure we find various gradations of public-private partnerships, where a growing number of tasks are delegated to private companies. These range from service contracts to 'Build-Operate-Transfer' contracts to long-term concession contracts. The delegation of tasks and powers is widely known as the French model.

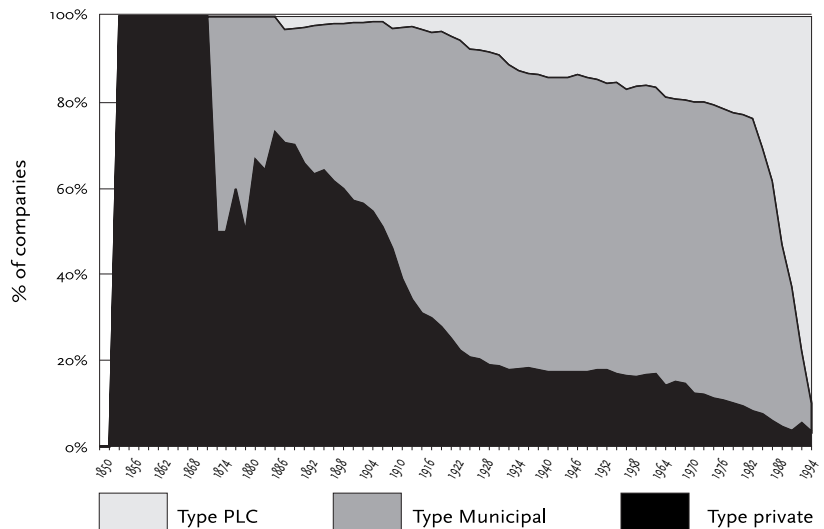
Top right we find the private utility, which is both privately owned and privately managed. This variant is commonly known as the British model. The government sees to it that the utilities do not abuse their monopoly.

Unlike the corporatised utilities and the public utilities, the Public Water PLC is a commercial business, subject to private sector rules and regulations. As regards utility management, it is therefore equivalent to a private company. Unlike a private company, however, its shares are owned by the government.

# 1 HISTORY

Thanks to private initiative and foreign capital (from Britain and Belgium) an increasing number of Dutch cities had a public water supply system by the second half of the nineteenth century. Amsterdam was one of the first to be served, with water being abstracted from the dunes, followed later by The Hague, Rotterdam and medium-sized towns like Delft and Leiden. The development of the public water supply was triggered by the appallingly unhygienic conditions in which large sections of the urban population lived at that time. The main source of drinking water was the canals, which were also used as a bathtub and toilet. Not surprisingly, therefore, repeated cholera epidemics had swept through Dutch towns and cities in the mid-eighteenth century.

Institutional Form  
of Water Supply  
Utilities in the  
Netherlands,  
1850 - 1994



Initially privately owned, the drinking water supply system fell into local government hands around the turn of the century. There were several reasons for this. One was that public hygiene was increasingly seen as a job for the government. Another reason was that private financiers could get a better rate of return on investment elsewhere, and certainly now that drinking water was also to be made available to less well-off groups in the city.

The development of a public drinking water supply system was not just restricted to the cities. During the first half of the 20th century rural areas also began to benefit from safe, clean drinking water. The investments required for this exceeded the pockets of the individual local authorities, however.

Regional water supply companies were set up, often in the form of public limited companies with multiple municipal shareholders. By about 1940, the Netherlands had over 230 water supply utilities. Of these 150 were under municipal management, 30 were intermunicipal, two were provincial and three were government-owned. There were also 40 private utilities.

The period following the First World War was marked by rapid economic development and population growth. Between 1945 and 1970, demand for water quadrupled. At the same time, pollution levels increased. Water supply companies had to invest more and more in water treatment facilities. To guarantee good-quality drinking water, further upscaling was necessary. From the late 1950s on there were a series of amalgamations and partnerships, partly due to pressure exerted by national government. The number of water supply utilities decreased from 230 in 1940 to 185 in 1965, and 40 in 1994. Some key figures for the Dutch drinking water utilities are shown on the previous page.

## 2 PRESENT SITUATION

The Netherlands currently has some thirty regional water utilities. Most are organised vertically, i.e. they are responsible for abstraction and treatment, as well as for distribution (to the customer's front door). The user pays for the number of cubic metres used in addition to a standing charge. In the interests of saving water the standing charge proportion has been significantly reduced in recent years. Despite this, at an average of NLG 2.50 per cubic metre the price of water is still proportionately low. The combined total annual turnover of the water supply companies is approximately NLG 3 billion, with investments around NLG 1 billion per annum (1995 figures). Investment costs (interest and depreciation) and operating costs are recovered in full from the customers.

Compared with other companies, water supply companies occupy a good position on the capital market. Equity levels may be low, but borrowing money - usually on favourable terms - is no problem. The aspect that financiers find particularly attractive is the fact that the companies involved combine a regional monopoly with a fairly fixed sales market.

The second half of the chain - after use - does not come under the responsibility of the water supply companies. The sewerage system for removing wastewater is owned and managed by the local authority. Users pay a fixed amount per annum for this service, usually as part of their municipal taxes. The treatment of wastewater is a task for wastewater treatment boards or water boards, which are separate administrative bodies that were set up centuries ago to protect the country against flooding. Nowadays they are responsible for the total management of surface water. Every inhabitant of the Netherlands pays an annual tax for the treatment of domestic wastewater. Companies also pay a tax in proportion to the number of population equivalents (p.e.) they discharge.

Of the 29 Dutch water supply companies, 26 are organised as public limited companies, two are under direct municipal management and there is one private utility. Within their service area the water supply companies enjoy a monopoly. The present structure was recently confirmed in the general outline of the new Water Supply Act. Some degree of privatisation will probably be introduced. Customers who use more than 100,000 cubic metres of water will be able to choose their own supplier.

The Dutch water industry is well organised. Almost all of the water supply companies belong to the VEWIN (Netherlands Waterworks Association), a national organisation that promotes the interests of its members at national and international level and also contributes to enhancing their expertise.

This covers not only water abstraction and distribution, but also areas such as nature conservation in abstraction areas and corporate environmental care.

The standard of technical expertise in the Dutch water business is high; political sensitivity is sometimes rather lower. Senior water company staff often share the same professional and educational background. Trade journals, courses and the mutual exchange of information help maintain and improve know-how.

Most Dutch water supply companies operate a system of reciprocal comparison of financial performance. The main aim is to identify whether a particular company is out of line with the others in certain respects.

Investments are usually financed from depreciation, supplemented where necessary by commercial loans. Government subsidies are unknown in the Netherlands: the water supply companies rely entirely on their users and on the financial markets.

### 3 PUBLIC WATER PLCs

A Public Water PLC, like other public and private limited companies, is governed by company law. The public limited company is a legal entity that has been devised to procure public and private capital to run the business. The shareholders have only limited powers, but also have limited liability. They are not required to share in company losses beyond the value of the capital they have subscribed.

Company law prescribes both the management structure and the financial reporting requirements of the PLC. With regard to management, a distinction is made between the managing director, the board of directors, the shareholders and the works council. The managing director or the management is responsible for the day-to-day management of the PLC and keeps an eye on the interests of the company. Company interests also guide the decisions of the board of directors. The board supervises company policy and management. One of its principal powers is the appointment and dismissal of the managing director. Earlier it was mentioned that the shareholders have little influence on company policy. They do draw up the company bye-laws, however, and have the power to accept or reject the annual accounts. The employees also have a formal say in matters concerning the company. The works council has the right to advise on virtually all strategic decisions.

Besides these formal actors, who are specifically mentioned in the legislation, company policy is also influenced by informal actors, such as consumers. The Netherlands has an active Consumers' Association, which, for instance, annually compares the water supply companies on the basis of price and quality. Other informal actors include other water utilities, professional associations, environmental groups, the press (both general and trade) and - last but not least - professional colleagues. Most people in the water supply business know one another and are not afraid to pass criticism on the actions of their peers - albeit within the confines of the industry.

Dutch public limited companies have to report regularly on their activities. Every quarter, for example, a financial review has to be prepared for the shareholders and the works council. An annual report and accounts must also be drawn up and approved by an external auditor. In addition, PLCs have to publish a social annual report. Most water supply companies also produce an environmental report as part of their corporate environmental care system.

## 4 CHECKS AND BALANCES

The PLC structure encompasses a series of checks and balances, both formal and informal, which ensure that the interests of all concerned are taken into account equally, and would therefore seem to be ideally suited to the water supply industry. These limit the possibilities of mismanagement or abuse of the organisation, for example for political ends. Formal checks and balances are either laid down in company law or stipulated in legislation specifically geared towards water supply companies. Informal checks and balances are not stipulated in writing anywhere, but have been developed by the actors themselves. This system of formal and informal checks and balances underpins the combination of efficient commercial operations and public accountability.

Formal checks and balances include:

- the public has free access to the annual accounts, which shed light on the company's performance, solvency and liquidity;
- company law and the bye-laws of PLCs divide powers and responsibilities among the various actors;
- through the shareholders (most of them elected administrators) the general public can influence policy to some extent;
- the bye-laws of most water supply companies do not allow shareholders to hold more than 50% of the shares;
- no one municipality can supply more than half the members of the board of directors;
- in the event of bankruptcy as a result of mismanagement, the managing director can be held personally responsible;
- the managing director is also held responsible for the presentation of any misleading information.

Informal checks and balances include:

- officially, the members of the board of directors are to be guided solely by company interests. In practice, however, as elected administrators, they also take the interests of those they represent into account;
- the board of directors has an informal agreement that its members should come from all regions within the utility's service area, thus ensuring that certain regions are not neglected.

## 5 PERFORMANCE

The performance of Dutch water supply utilities is excellent. A recent survey revealed that users are very satisfied with both the taste and the hygienic quality of drinking water. The water supply companies are also doing well in terms of productivity. If we look at commercial criteria, the following picture emerges:

- coverage is close to 100%;
- percentage of unaccounted-for-water is low (4.3%);
- water quality is excellent;
- reliability of supply is high, even in the summer;
- the price is low.

Aside from these commercial considerations, Dutch water supply companies also score well when it comes to social criteria. For instance, demand for water, at 130 litres per person per day, is limited compared with countries with the same standard of living. Water supply companies pursue an active policy to prevent wastage by customers. Water-saving programmes aimed at both domestic consumers and large industrial users have been introduced. Dutch water utilities also play a very pro-active part in protecting their water sources (groundwater and surface water) against pollution. Adhering to the credo that 'attack is the best form of defence', water supply companies have positioned themselves as watchdogs over the water environment, often working in cooperation with environmental organisations.

In their role as watchdogs, water supply companies perform various tasks. These include:

- detecting pollution and determining its origin;
- lobbying the media and the government and/or taking legal action to fight pollution;
- attempting to prevent future pollution by influencing policymakers and the media;
- encouraging polluters or potential polluters to prevent or stop pollution.

## 6 EXPERIENCE IN OTHER COUNTRIES

The water utility as Public Water PLC is not unique to the Netherlands, or even to North-West Europe. Other countries have also opted for this organisational mode, which illustrates its flexibility. Three examples are discussed below: Poland, Chile and the Philippines.

### POLAND

Like all of Central Europe and the former Soviet Union, Poland went through the transition from communism to capitalism in the early 1990s. One of the consequences was that water management was devolved from State to local level. Nearly all water utilities are still under municipal control to this day. Only the municipality of Bielsko-Biala in the southernmost part of Poland has turned its water utility into a Public Water PLC. And with great success. The company has managed to cut water losses drastically, for instance by concentrating on replacing the distribution network. Energy consumption has also fallen sharply and other operating costs have been reduced. The distorted tariff structure has also been tackled: households now pay realistic rates for the water they consume. Partly as a result of this, the company is in good financial health, as evidenced by the recent loan granted by the World Bank.

### CHILE

In 1989 several water supply companies in Chile were converted overnight from corporatised utilities into Public Water PLCs. These supply both drinking water and wastewater treatment services. The change has had a positive impact on the performance of the companies concerned. The level of investment has risen, as has efficiency. The number of employees per 1000 connections (a measure of efficiency) has dropped by 17% to 1.9. Prices have increased by 70%, which has improved the financial results. One interesting feature of the Chilean system is that it has a regulator (Superintendencia de Servicios Sanitarios) who has independent status and reports directly to the President of the Republic. The regulator is empowered to intervene if a utility fails to comply with the rules, and can also set tariffs and grant and revoke concessions.

### THE PHILIPPINES

Water supply services in the Philippines are provided for the most part by 400 water districts, each with the status of a public limited company whose shares are owned by the government. Each water district has a board of directors composed of five members, who represent customers' interests (business, households, women's organisations, etc.). In practice, the Board acts as an effective buffer between the utility business and local politics. A salient feature of the water supply business in the Philippines is the existence of the Local Water Utilities Administration, which is a central agency that provides both

technical and financial support to the regional water utilities and also acts as an unofficial regulator.

There are many more examples from all over the world that could be added to this list. This shows that a water supply company that is organised according to the Public Water PLC model can function under diverse political and social circumstances and characteristics and can help utilities to achieve the dual and conflicting goals of water supply: to extend affordable services to all and to recover costs from customers.

## 7 SUCCESS FACTORS

As an organisational mode for water utilities the Public Water PLC is appropriate in all kinds of environments. As we have seen, it is a very flexible structure and can significantly improve water supply services within a very short time, in terms of both supply mechanisms and cost effectiveness. Depending on the local situation, various success factors have a part to play.

- One important factor is the political will to make the public water supply system a success. This is no easy task, as politicians and administrators - paradoxically enough - have to relinquish a degree of influence to make this happen.
- The shares and the seats on the board of directors must be divided carefully among the various local authorities to prevent one local authority gaining the upper hand.
- Encouraging local share ownership is important as it ensures that the customers can influence policy. Local involvement is increased by appointing representatives of local authorities or consumers.
- It is advisable to consider private minority shareholding in the PLC. The introduction of private shareholding is likely to increase pressure on the management to improve efficiency. It also means that the water utility can benefit from the private shareholder's knowledge of the market.
- It is vital that the board of directors possesses sufficient utility-specific expertise in the fields of engineering, finance, environmental protection and human resources. This prevents a knowledge imbalance between the managing director and the board.
- Company law must ensure that Public Water PLCs are accountable for their actions, just like other businesses. This transparency is essential to prevent abuse of power and mismanagement.
- It may be advisable to appoint an independent regulator, for instance to reduce political intervention and guard against both technical and financial mismanagement of the water utility.

## 8 DIFFERENT ENVIRONMENTS

The Public Water PLC structure for the water supply business functions well in very different technical and legal environments. In principle, this organisational mode can be used anywhere. The advantages are particularly evident if we look at public water supply in secondary (i.e. medium-sized) towns and in countries where privatisation of the water supply sector is socially undesirable or legally impossible.

### SECONDARY TOWNS

Roughly a quarter of the world's population (1.2 billion people) live in cities with fewer than 500,000 inhabitants. While in rural areas water supply services are often community-managed, cities are too large for this option. One particular reason for this is that the scale of water services required demands a professional organisation. Private companies, on the other hand, find secondary towns too small, because they cannot take sufficient advantage of economies of scale. In these areas the Public Water PLC is actually the only alternative to ensure acceptable standards of water supply services. On the one hand, the Public Water PLC has a sufficient level of professionalism and has easy access to investment capital; on the other, its task is to serve the public interest by providing adequate water supply services.

### SOCIAL NEED

In a number of countries privatisation of the water supply industry is socially, and hence politically, unacceptable. Developing countries are not alone in this respect. Even in the Netherlands most people are not in favour of privatising the water sector, because water is regarded as one of the basic necessities of life. At the same time, however, there are major drawbacks to a system in which water utilities are owned and operated by the government. The lack of autonomy and commercial orientation often leads to less than optimum performance. Under these circumstances, the Public Water PLC is often a socially acceptable form of privatisation. Since the water utility remains the property of the government - and hence of the public - the importance of providing water for all is fully appreciated.

### STATUTORY OBLIGATION

In some countries the public ownership of utilities, including water supply companies, is enshrined in law. Privatisation is difficult, because the entire legislative structure has to be re-examined. This is why a decision is made to place water supply services under the control of a government agency or state-owned company, with the inevitable risk that such a body will not be able to do its job properly, for instance due to political intervention in its day-to-day management. By transferring responsibility for water supply services to a Public Water PLC, it is possible to adhere to the law that mandates public ownership while shielding the utility from public rules and regulations that are incompatible with the commercial side of the water business.

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## GOVERNMENT SHAREHOLDINGS IN WATER COMPANIES

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Postbus 2727

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The Netherlands

Fax (from outside the Netherlands): +31 70 339 1568

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