



Commercializing local government water departments



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AMONG THE PRIMARY responsibilities of municipal councils in Kenya is, development, operation, maintenance and expansion of the infrastructure required to ensure the provision of potable water and adequate sanitation services. The level at which these services are provided in many Local Authorities leaves a lot to be desired.

Before these services can improve changes will be required in the institutional framework, amongst other things. This fact has been recognised by the Ministry of Local Government (MoLG), and the Government of the Republic of Germany, who have invested some US\$330 million in the sector in recent years. The MoLG, supported by the German Technical Cooperation Agency (GTZ), has therefore established the Urban Water and Sanitation Management Project (UWASAM) within the Urban Development Department (UDD) of the Ministry. The project aims at assisting water-undertaking Local Authorities in attaining self-sustainability of their water and sanitation services.

UWASAM Project

The UWASAM project has now entered its 4th phase (January 1997-December 1999). In this phase the emphasis is very firmly on the commercialization of water-undertaking Local Authorities.

The project builds upon the experience acquired during a pilot phase (July 1987-December 1993). This experience was gained in the municipalities of Kitale, Kericho and Nyahururu. In these towns detailed assessments of the water and sanitation services were carried out and tools for technical and financial management of these services were developed.

In its previous phase (January 1994-December 1996) the financial management guidelines, developed during the pilot phase, were implemented in the 9 target municipalities of: Kitale; Kericho; Nyahuru; Eldoret; Kisumu; Nakuru; Nanyuki; Nyeri; Thika. It was recognised at this time that if financial viability was to be attained financial autonomy from the Council would be required. Water and Sanitation Departments (WSD's) were therefore established in these 9 Local Authorities, each with its own General Manager, Commercial Manager, and separate bank account. This phase continued to assist in improving Operation and Maintenance of water and sanitation facilities, using the experienced personnel in the UDD. The project also supported the staff of the UDD by employing full-time local engineering and financial consultants, and an experienced

expatriate water manager. Public awareness workshops were also held and action committees formed.

Remaining problems

Although the creation of WSD's resulted in some improvement in the running of these services it soon became apparent that certain problems were inherent within the Local Government structure, and that these could not be solved even by the creation of a separate department still within that structure. Examples of such problems are:

- The non-application of cost covering tariffs, in order to obtain short-term popularity;
- Delays in approval of tariffs and budgets, due to long bureaucratic approvals procedure;
- Diversion of water revenues to unrelated expenditures at the expense of water services;
- Difficulty of recruitment, and retention of professional, top and middle management staff;
- Over-staffing at unskilled personnel levels.

The management options

In April 1996 the MoLG accepted in principle the need to introduce a commercial approach into the water and sanitation operations of its Local Authorities. A working group prepared a paper setting out the following 3 basic institutional options as given by the World Bank's World Development report 1994:

Option A

Combines public ownership of the investments with public management and operation of the system.

Option B

Combines public ownership of the investments with private management and operation of the system;

Option C

Combines private ownership of the investments with private management and operation of the system.

Option C involves full privatisation, which is not the preferred concept at present, and which was not therefore developed any further. In considering the options listed above a key aspect taken into account was the current Local Authority responsibility for, and ownership of, the water supply and sanitation assets. It was strongly felt that ownership of the fixed assets should remain wholly with the municipal councils. The basic options A and B were,

therefore, broken into sub-options, and their main characteristics were listed as follows:

Option A1: Public Department (WSD)

- Purely public sector
- Lack of autonomy
- Lack of efficiency
- Lack of incentives
- Imposes management constraints.

Option A2: Public enterprise (WSC)

- Public controls
- Public policy objectives
- Relatively independent operation
- Modest incentives for efficiency.

Option B1: Service contracts

- High incentives for efficiency
- Commercial orientation in management
- Autonomy in personnel matters
- Public control of financing remains
- Normal length of 1-2 years.

Option B2: Management contracts

- Introduces commercial experience
- Increases private sector participation
- Defines service standards
- Management autonomy
- High incentives for efficiency
- Financial management autonomy
- Normal length of 3-5 years.

Option B3: Lease contracts

- Medium to long term assignment
- Lessee provides working capital
- Lessee provides O&M financing
- Motive is strict commercial objectives
- Incentives for efficient operation
- Limited commercial risk
- Normal length of 5-10 years (but up to 20).

Option B4: Concessions

- Long term assignment to concession holder
- Specific performance targets set
- Concessionaire assumes commercial risk
- Direct legal relationship with consumers
- Performance indemnity guarantee necessary.

Having considered the various options outlined above the decision was taken to adopt a mix of public sector ownership and private operation/management models as represented by Options A2 and B2, since it was considered that this would be compatible with the current institutional capacity in the Local Government sector. This became the official Government policy, which was accepted for implementation, on a pilot basis in the municipalities of Eldoret, Kericho and Nyeri.

Water and sanitation companies defined

A study tour was undertaken to Zambia and Malawi, in May 1996, to enable councillors and officials to visit water and sanitation organisations in neighbouring countries which had been operating on a commercial basis for many years. Following the study tour workshops were held in June and September 1996, at which officials from the MoLG, MLRRWD, Municipal Councils, and the donor agencies, defined the shape of the Water and Sanitation Companies (WSC's). One-day workshops were also held with all the elected members of the 3 municipal councils involved, at which the principal features of WSC's were explained and debated. Kericho and Nyeri Municipal Councils had an additional meeting of their elected members to coordinate their views on the issue.

By September 1996 the 3 Councils, of Eldoret, Kericho and Nyeri, had passed resolutions to form WSC's.

Structure of the water and sanitation companies

The WSC's are to be established and operate under the Companies Act, Chapter 486 of the Laws of Kenya. The structure will be that of a normal company, with Shareholders; Board of Directors; Management. The shareholders will be the members of the Municipal Councils, and any additional nominees required to satisfy the requirements of the Companies Act. They would normally exercise power over the operations of the company by means of the Annual General Meeting (AGM).

The shareholders will appoint a Board of 9 Directors with the following composition:

- 1 elected representative nominated by the Municipal Council
- 1 chief executive of the company
- 1 representative from the business/financial sector of the community
- 1 representative from a local women's organisation
- 1 representative from the consumers
- 2 officers of the Municipal Council
- 1 non-voting representative from the MoLG
- 1 non-voting representative from the MLRRWD.

The Board will be responsible for the implementation of the Company's Memorandum and Articles of Association, and for providing guidance and control over the operation of the Company.

The Company's Corporate Management Team will comprise the chief executive; financial manager; and operations manager. The top management of the company will be recruited in the open market, and be employed on contract terms. This contract of employment will contain performance-related clauses. The management of the company will be responsible for the day-to-day operation of the company in order to provide for the effective and efficient provision of water and sanitation services throughout the municipal council area at optimum cost. These

operations will be guided by an Agreement for the Provision of Services on an Agency Basis, drawn up between the Municipal Council and the Company.

Contentious issues

As part of the process of establishing these new companies certain objections have to be resolved. Primary amongst these is the possibility of staff redundancies. Those factions opposed to any form of commercialization have seized upon this as a sensitive issue, and used it as a weapon to frighten the elected councillors. If the companies are to succeed they should not be burdened by the large numbers of deadwood presently employed by the Council-run WSD's. Following lengthy discussions on the issue it has been agreed that all staff employed by the WSD's should initially be transferred, on a temporary basis, to the WSC's, while still remaining Council employees. Within their first year of operation the WSC's should select which staff they wish to employ on a permanent basis, and which staff should remain with the Council.

One other contentious issue is the extent to which the Council should retain control of the company, through the AGM. Of particular concern to the Council is retention of control of water and sewage tariff increases. As noted earlier there is a history amongst Local Authorities of non-application of cost covering tariffs, for reasons of short-term political popularity. At the same time if the WSC's are to succeed they must be able to control, through their Boards of Directors, their single source of income. It is necessary for the AGM (the elected councillors) to have sufficient confidence in its Board to allow it to set the tariff levels. This degree of trust can only be achieved over a period of time. In its formative years it may be necessary for the Board to provide detailed financial evidence directly to the controlling ministry to prove that any tariff increase is fully justified, and that the same result cannot be achieved by a decrease in expenditure levels.

The other area of concern to the elected councillors, is the facility which it will lose, on the formation of the WSC's, to transfer funds from the water account to meet other pressing financial obligations. As part of its assistance to the municipal councils the UWASAM project has arranged for Potential Revenue Studies to be conducted in the 3 affected municipal councils. These studies assist the councils in identifying alternative sources of revenues which can be developed, and thus reduce the council's dependence on water revenues. These studies have made the councils aware of the many other sources of revenue

available to them, which they have either under- utilised, or ignored, so long as the steady source of water revenues remained.

Another source of friction between the councils and the companies has been identified as arising from the company's enjoying better conditions of employment than the senior council staff. This issue can only be resolved by equating remuneration with risk, and pointing out to the council's staff that the company's staff will be employed on a contract basis with the risk of cancellation or non-renewal of the contract if the performance criteria are not met.

The general approach being adopted in dealing with contentious issues, such as those outlined above, is to provide facilities for these issues to be fully discussed, such as at workshops attended by elected representatives, local and central government officials, together with technical , financial and legal advisers provided by the UWASAM project. It is hoped that by this means guided discussion will lead to acceptance of the need for commercialization, and acceptance of the formation of WSC's as a first step in this direction.

Establishment of water and sanitation companies

In November 1996 a Plan of Operation was prepared setting out the programme of activities required, during 1997, in order to establish WSC's in Eldoret, Kericho and Nyeri Municipal Councils. Early in 1997 consultants were appointed to prepare Asset Registers to help determine the assets and liabilities of the Councils to be transferred to the new companies. A firm of legal consultants was also retained to advise and assist the councils in the drawing-up of the Memorandum and Articles of Association of the company, and the operating Agreement between the council and the company. The current programme aims at having the 3 new companies fully established by the end of 1997.

Conclusion

A progress update on the establishment of WSC's will be provided at the conference.

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