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Don't Want to Privatize? Then Corporatize (But Do it Right)

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About the Author...



For over thirty years **Jerome Donovan** has been a legal advisor and consultant to many developing countries, most recently in the Middle East and the Balkans, specializing in public-private partnerships, procurement, and utility regulation. He graduated from Yale and Columbia Law School and lives in Falls Church, Virginia.

Abstract

Privatization of public utilities in the developing world is on the defensive. Governments are looking for new ways to deliver services, and many are trying an alternative called “corporatization.” In this article, author Jerome Donovan defines corporatization, and discusses its strengths and how to avoid common pitfalls in its implementation.

Privatization in Winter

The outright privatization of public services in developing countries, especially in the water/wastewater sector, has hit a jolting downdraft. In recent years country after country have either cancelled or sharply curtailed privatization projects or refused new ones.

Growing public dissatisfaction with the results of past privatizations have forced many governments to tune out the traditional arguments in favor of handing over to the private sector the difficult job of delivering essential services. Chief among those arguments:

- Private companies, especially those from the developed world, have the management and technical expertise to ensure the efficient and dependable production and distribution of the service in question, be it electricity, water, solid waste disposal, or transportation. Unlike the ministries and departments that have traditionally been in charge, private companies don't tolerate overstaffing, under-trained personnel, and obsolete technology.
- Private companies have privileged access to financing, thanks to their long associations with private banks and suppliers, and official export credit agencies in their own countries.
- Once the rules of the game – the contract governing the project in question – have been established, private companies are less vulnerable than cumbersome government agencies to political interference and whimsical rule changes.
- Privatization has a beneficial knock-on effect for the host country. A successfully privatized utility emits a seductive “demonstration effect” to other potential investors, encouraging them to invest, too.
- Perhaps most important, private companies bring to the enterprise the “discipline of the marketplace” – the practiced ability, born of

necessity, to respond quickly to customer complaints about shoddy service and shareholder complaints about anemic financial returns. Unlike inefficient government bureaucracies, private companies have both “met a payroll” and made a profit.

But that was then. Now, privatization is more frequently playing defense, especially in Latin America. Countries once in the forefront of the privatization movement are pulling back inside the fortress they know so well, the traditional utilities whose perceived sluggishness had so recently given birth to that movement. Some recent examples:¹

- In 2005, El Alto, Bolivia, public demonstrations over poor service resulted in the suspension of the city’s arrangement with Suez, a major player in the world water market.
- Five years earlier, the Bolivian city of Cochabamba ushered out Bechtel, which had a water contract, claiming that the company had raised rates but not performance.
- In March of this year Argentina cancelled its thirty-year water contract with Suez and placed the sector back in the hands of the government.

Nor did privatizers find many friends at the March meeting of the World Water Forum. In fact, the anti-privatization tide was running so strongly that one major advocate of privatization urged that international water companies and, presumably, donor countries as well, confine their efforts to the fifty neediest countries and the twenty poorest megacities.²

Enter Corporatization

In this fractious atmosphere, some countries disillusioned with privatization are withdrawing to a line of defense short of returning to the government castle and pulling up the drawbridge.

On the one hand, they want to pacify a surly public by re-shouldering a responsibility that many citizens think they should not have handed off in the first place: direct accountability for delivering services.

On the other hand, they (at least privately) acknowledge their inability to deliver satisfactory services saddled as they are with antiquated hiring practices, poorly trained staff, insufficient financing, and poor morale.

Increasingly, such countries think they may have found a solution in corporatization.

In **Ontario**, an expert panel found that where provincial policy ruled out privatization of water and wastewater assets, corporatization “offers the greatest benefits in terms of governance, transparency, financial sustainability and accountability” for long-term financing and organization of the sector.

Swain, Lazar, Pine, “Watertight: The case for change in Ontario’s water and wastewater sector: Report of the Water Strategy Expert Panel, Queens Printer for Ontario, 2005.

What Is Corporatization?

In its simplest terms, corporatization is an attempt to capture some of the benefits widely associated with private companies (e.g., efficiency, access to financing, productivity, *esprit de*

¹ Monte Reel, “Turning the Taps Back to the States,” *The Washington Post*, Mar. 27, 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/03/26/AR2006032600861.html>

² Elizabeth Malkin, “At World Forum, Support Erodes for Private Management of Water,” *The New York Times*, Mar. 20, 2006, <http://select.nytimes.com/gst/abstract.html?res=F4061EFD34550C738EDDAA0894DE404482>

corps) without turning the sector over to them and, at the same time, reassuming a clearer responsibility for results.

Typically, corporatization at the very least involves a utility's taking the form of a private company but not the substance. This might mean the government's forming a separate – even private – form of corporation or company, wholly outside the official government framework, and issuing shares to one or more government units, one of which is almost certain to be the public utility that has kept – or regained – control of the sector.

Modern accounting and management practices might be mandated, and a board of directors, operating under a modern charter (memorandum and articles of association), put in place.

Hiring practices may be streamlined, with pay scales and promotion procedures made sufficiently attractive to entice the country's best talent.

Strict monitoring of performance and effective reporting practices are installed. Community-relations are given high priority; the utility knows it must get closer to the users, tell them what's happening and what they can expect to happen in the near future.

Procurement procedures are simplified and tightened, made more transparent. Insider deals are minimized if not eliminated.

In short, make the utility look like a private company, at least from the outside.

Ideally, the corporation's legal structure would permit it to eventually offer shares to private investors, but the corporation could delay this step until it had a track record of satisfactory performance.

Does Corporatization Work?

It's too soon to tell, and the indicators point in both directions. But one thing is abundantly clear: unless the utility *acts* like a private company and not just *looks* like one, corporatization will founder on the same shoals that marooned privatization.

In **Hungary**, the Debrecen Water Works Company was structured to provide a large degree of management autonomy. While the city government is a 100 percent shareholder of the company, key business decisions in areas such as personnel, operations, and investments (except for exceptionally large investments) are in the hands of utility management.

"Case Studies of Bankable Water and Sewerage Utilities," United States Agency for International Development, August 2005.

Corporatization in Egypt

In April 2004, a Presidential Decree corporatized the Alexandria Water Company (AWCO) by making it one of several subsidiary utilities of the public sector holding company. Conditions of AWCO's new corporate structure include:

- AWCO is no longer subject to civil service regulations with respect to hiring, salaries, and retirement; giving it more flexibility to implement merit-based staff evaluations and incentive programs.
- Outsourcing is now legal, relieving company of need to carry excessive staff, facilities, and equipment.
- AWCO can retain control of revenues and make investment decisions on any surplus revenues.

"Case Studies of Bankable Water and Sewerage Utilities," United States Agency for International Development, August 2005.

Perhaps a corporatized utility's major challenge will be to change its attitude – its "corporate culture" – regarding its duties. Once the exhilaration of doing business "just like a private company" subsides, a relapse into "business as usual" must be resisted. Actually operating the utility as a business and not a sinecure will require strong leadership from the company's top executives and the board of directors.

Each member of the board, especially if they are all public officials, must have the vision and courage to represent the best interests of the public, and not be just “potted plants” – attending meetings, collecting their fees, and not providing anything useful to the company.

An unforeseen benefit of doing it right might be this: if private companies see that the government is serious and efficient, more of them might be willing to invest in the country

Other Dangers

Perhaps what most haunts the newly corporatized utility that is (at least at first) wholly owned by government agencies is that the government will not let it have sole control of its revenues.

The government will be tempted to siphon off the new corporation’s profits to fund other projects in the sector. This, in turn, will virtually assure that the corporation will have insufficient funds to finance its own O&M costs and the capital costs of expanding the system – be it water/wastewater, power, or transport – that, by its charter, the corporation is obligated to undertake.

How can the new company avoid this fate? First, by knowing the risk. Then, from the very beginning of its corporate existence, it must “ring-fence” its revenues: structure its foundational legal documents – articles of association, for one – so as to foreclose any legal way for the government to unilaterally tap its treasury.

The stakes are high. Privatization flourished for a while because governments couldn’t deliver services in ways that their people found satisfactory. Now that the privatization torch is dimming, governments are scrambling to pacify the people and find other solutions. Those who try corporatization and fail to make it work, risk incurring an even higher level of public ire than before. This, in turn, will stoke an even more toxic public cynicism, and that could have messy political repercussions.

So by all means corporatize. But mean it and do it right.

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