

354

AMQ
International's

STRATEGIC ASSET MANAGEMENT

November 26, 2012

MANAGEMENT CONTRACTS



In this issue we look at two ways in which publicly owned utilities can gain the benefits of commercial initiative. First we look at the use of management contracts. These three articles are the result of my recent visit to Algiers. The first is “**An Algiers Success Story**” (2-3) in which we learn of a management contract that has transformed the lives of the citizens in Algiers in just on 5 years, and what made this possible. In “**The WIKTI**” (4-5) we look at an innovative information training and transfer tool that helped make this transformation possible and which has since been successfully applied around the world - and in Australia. In “**Win Win Contracts**” (6-7) we look at what the client is looking for and what the contractor is looking for, and how to evaluate the benefits of such contracts. Then, in “**Comparative Competition**” (8-9) we look at a way in which the Public Sector can gain from competition without privatisation. Finally, I introduce a new series “**Great Graphics**” (10) in which I present some of the more interesting graphics that deserve more than their 20 seconds of fame when flashed up on the screen.

Please enjoy!
Penny

Dr Penny Burns, Editor, AMQ International
08 8359 0559 www.amqi.com



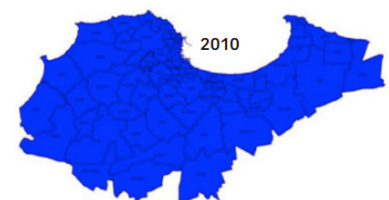
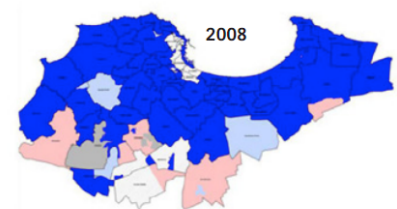
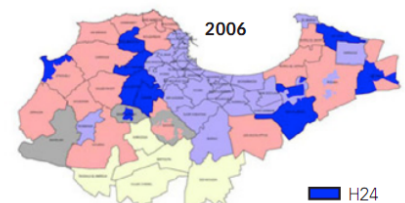
AN ALGIER SUCCESS STORY

Algiers, the capital of Algeria, has a beautiful location on the edge of the Mediterranean, a pleasant climate, nice beaches and proximity to Europe. (Paris is only an hour's flight away). But ten years ago it suffered from a degraded environment with traffic congestion, atmospheric pollution and bad odours, beaches polluted by raw sewage and lack of cleanliness of the streets. There were poor public services. There was unreliable and discontinuous water supply, absence of a formal water network in low income districts, flood risks during rainy events due to the bad maintenance of the sewer system.

In 2006, the Government of Algiers created SEEAL, a public authority, and awarded a management contract to Suez Environnement and Degremont. The population of the Province of Algiers are well pleased with the outcomes. Consider:

Water

In just five years the Province had attained universal 24 hour access, 100% fit for consumption, whereas previously water supply was sporadic and for most was just for 2-3 hours a day. (see map). Production means were rehabilitated. These consisted of 2 surface water treatment facilities (capacity 670,000 cubic metres per day) 263 bore wells, 88 pumping stations, and 268 reservoirs, with 4600 km of networks (130,000 leaks repaired in five years). Network performance improved despite the passage to a 24/7 service. (70% cf approx 50% in 2006)



Wastewater

By 2006 98% of waste water was being collected and the treatment rate had increased from less than 10% to 53%. This has resulted in the population now having access to 64 beaches in the summer where previously it was only 39%. This has been achieved by management of 3,300 km of network, 39 pumping stations, 4 waste water treatment plants (1.6 million equivalent in habitants)

Customer Relationships

One internationally referenced customer call centre (2000,000 calls per year, 97% efficiency), a latest generation customer information system, 330,000 metres installed. 59% growth in service income on a like for like basis and 87% of the population satisfied with the service.

Knowledge transfer

International standard achieved in terms of business maturity, 53,000 days of training given, 70% of training instructors are now local

What made this contract so successful? There were two principal factors. One, the Government was prepared to fund the capital improvements necessary and Two, the company knew how to prioritise the work as well as how to train and communicate essential knowledge to the local staff.

By the way this was achieved with the existing workforce where employee numbers (around 5,000) were determined by the need to keep people employed rather than to achieve optimum cost efficiency. How do you improve worker skills when workers are not incentivised to work?

What made this contract so successful?

There were two principal factors:

One, the Government was prepared to fund the capital improvements necessary and **Two**, the company knew how to prioritise the work as well as how to train and communicate essential knowledge to the local staff.

By the way this was achieved with the existing workforce where employee numbers (around 5,000) were determined by the need to keep people employed rather than to achieve optimum cost efficiency. This presented the problem how you improve worker skills when the workers are not incentivised to work. Part of the answer was in providing them with more job satisfaction.

We look at this job satisfaction, learning, information transfer tool, the WIKTI, in the next article. It is significant that even after 8 years in development, the company are still tweaking the system, making it easier to use, for example, now building it into an iPad application.

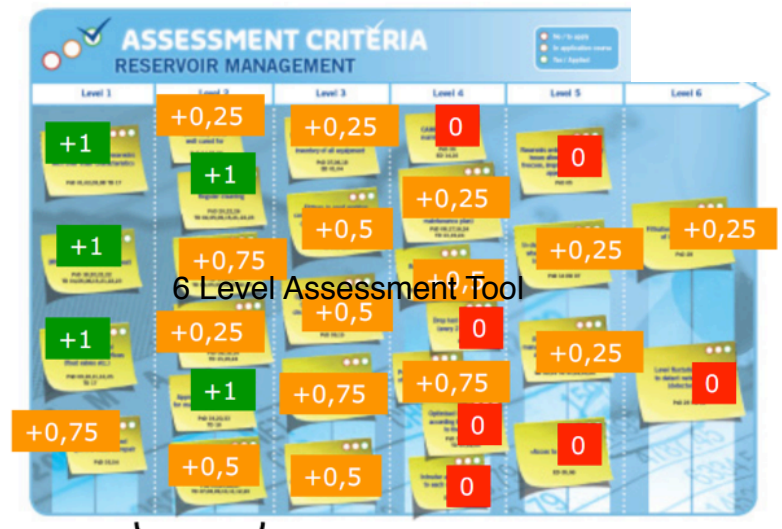
THE WIKTI (Water International Knowledge Transfer Initiative)

Step 1: Assessment

The WIKTI is the result of development over many years within Suez Environnement, and its application around the world. Although the individual processes may be common to all well functioning utilities, it is the way that they have been organised into a training and information transfer tool that makes the WIKTI so powerful.

The benefits have been shown to be:

- An improvement in the collective maturity level of water operator core business
- An efficient transfer of SE know how to customers
- A vision of the whole business processes and a roadmap shared by all
- A structured approach: common process segmentation, common tools, common human organization
- Measures based on 1500 criteria specific and concrete operations
- A tool for arbitration by management



The WIKTI is a 3 step process.

- Step 1. Segmentation
- Step 2. Deployment
- Step 3. Measurement

Step 1. Segmentation

Four areas, drinking water, waste water, customer services, and business management are further broken down into 38 business processes. For example drinking water is represented by 10 processes such as water treatment plant and pumping and transport network management, wastewater

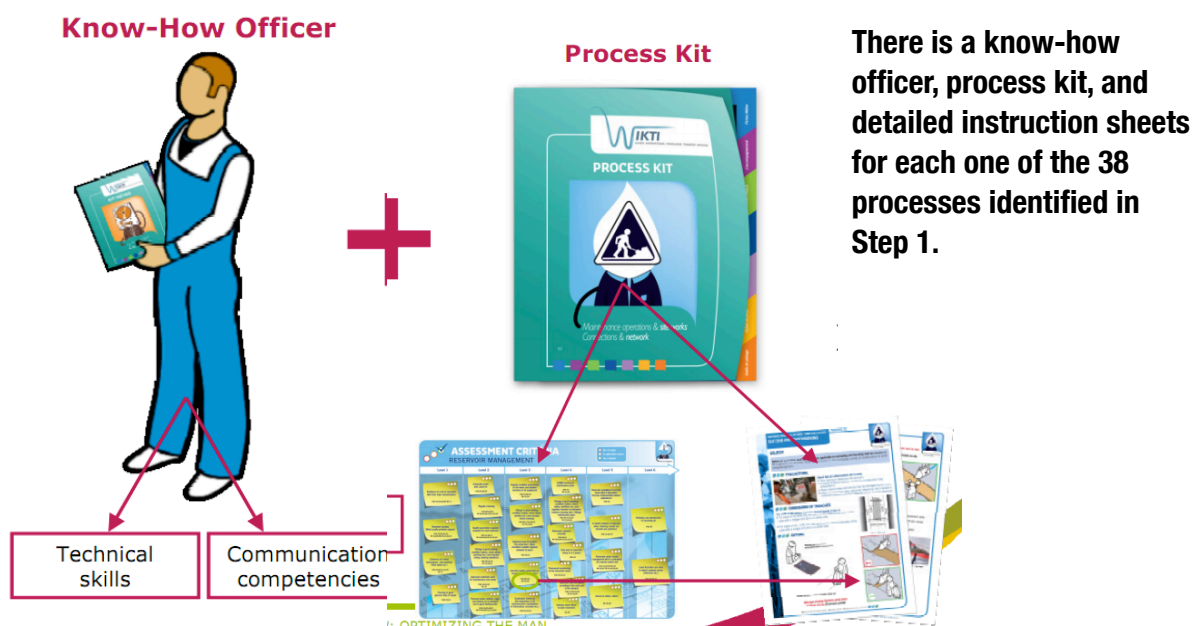


also has 10 processes, such as sewer diagnosis and sludge treatment and recovery. Customer services is represented by 9 processes, including customer database management and meter management. Whilst Business Management has 9 processes such as human resources training and accounting/controlling.

For each of the 38 processes there is a detailed 6 level assessment criteria, which is used to assess the starting position and to determine the targets and the actions that need to be taken to reach the targets. (Behind the actions lie detailed operations, some 1500 criteria specific operations.)

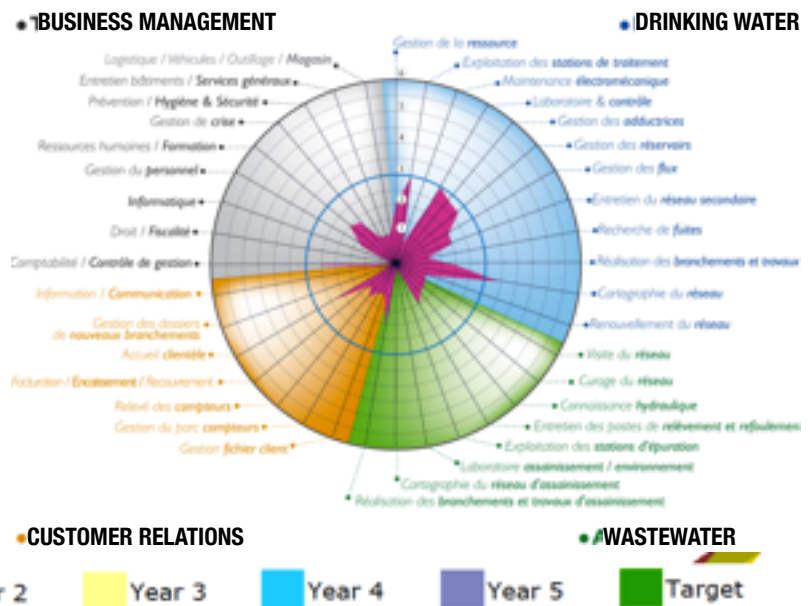
This information is used to assess the current position of the organisation and to determine future targets and appropriate actions to reach those targets.

Step 2. Deployment (Making it work on the ground)



Step 3. Measurement

The starting position for each of the 38 processes is measured in terms of 6 levels (see top diagram previous page) and year by year movement is measured on a spider diagram. In this way everyone can keep track of progress.



WIN-WIN MANAGEMENT CONTRACTS

The secret to a genuinely 'win-win' contract is to put as much time into understanding what the other side wants as what you want.

Whenever we have a Management Contract (where a private company brings its expertise to manage local staff and improve outputs and outcomes) we have on the one hand, the client's objectives and on the other the contractor's expectations. Both must be met for a successful contract.

Drivers	Client's objectives	Contractor Expectations
Responsibility Driver	Keep policy, tariff setting and regulatory functions	Commitment from stakeholders Leeway on decisions
Technical Driver	Improve specific operations Keep partial control of operations	(Partial) responsibility for operations Leverages of action for impact
Financial Driver	Improve commercial efficiency	Financing of investment plans Add-on HR policy and performance based remuneration
Human Driver	Reach autonomy through know-how transfer Keep staff in place	Sufficient number of own staff to achieve the desired results Executive positions (ditto)

THE STRENGTHS OF A MANAGEMENT CONTRACT

For the Client

- Benefit from renown expertise to improve utility's standards
- There is no obvious transfer to a private operator (which can be important for political reasons)
- There are visible results in a medium term
- For developing countries this is often a way to obtain international donor funding

THE STRENGTHS OF A MANAGEMENT CONTRACT

For the Contractor

- Flexible project structures
- No need for capital investment
- Easy to get in, easy to get out
- Limited risk transfer
- Limited interference with trade unions

THE CHALLENGES OF A MANAGEMENT CONTRACT

Before the Contract

- Long and expensive development process

Over the life of the Contract

- No full control on operations, nor on Capex
- Could be assimilated to technical assistance
- Need to mobilise a significant number of expats
- Setting of reasonable KPIs, achievable and measurable with a grace period
- Difficult to measure know-how transfer
- Results for contractor depend on goodwill of clients, on investments, on HR and on communication
- For the contractor, the revenues are generally low (this may be an attraction for clients but win-win contracts requires that both parties benefit from the contract)

At the end of the contract

- Exit
- Renew
- Transform

How do you measure the benefits of, say, a water management or transport contract?

In addition to any cost savings, it may be worth considering that in a globalised world, cities compete like counties or firms do. Large cities are ranked by specialised agencies for their capacity to attract talents, business, investors and visitors. Improving the city position in those rankings will increasingly be a goal for cities. City attractiveness is a complex concept, mixing quality of life (liveability) and prerequisites for economic development. A management contract can play a significant role in these areas.

It is commonly argued that to get the innovation benefits that are thought to result from competition, it is necessary to privatise. Or, to engage private contractors (cf the management contracts discussed above). However, Victoria did not privatise its water utilities - and yet it still benefitted from incredible improvements in management, operations, service quality and customer relations.

In the International Asset Management Competitions that I conducted between 1996 and 2000, the Victorian Water Retailing Companies were responsible for over one third of the awards granted. They were enormously productive, using a structure that was known as “Comparative Competition”

The following is just the first page of “From Here to Extraordinary” a submission by Dr Kein Gan to the VCEC Review of Metropolitan Retail Water Companies, in 2007. Dr. Kein Gan was the Water Supply-Demand Manager of Yarra Valley Water. His submission was made in a private capacity and the views presented in his paper are not necessarily those of Yarra Valley Water, although I doubt that his observations made in this first page would find disagreement with any of the water companies at that time - or now.

FROM HERE TO EXTRAORDINARY

Submission to the VCEC Review of Metropolitan Retail Water Companies

Dr. Kein Gan

THE OLD MELBOURNE WATER

The old Board of Works and its successor, Melbourne Water, was a huge, unwieldy organisation occupying all of a 14-storey city tower. It had a deep hierarchy, headed by remote CEOs sitting in a high office, men who were in touch with few of the numerous workers who overstaffed the company. The anecdotes that emerge from this period are as amusing as they are telling. A simple technical drawing had to carry the imprimatur of more persons than its importance deserved; old files testify to letters from customers being passed from hand to hand, each adding little value other than a signature; field staff clocked in hours that lacked accountability; and one employee, when she requested more work, was reprimanded and advised to go shopping. Yet, although there was an embarrassment of riches in terms of staffing resources, care of customers and infrastructure alike left much to be desired. In those days, public consultation and customer satisfaction monitors were unheard of; you simply paid your bills and put up with whatever was your lot in terms of water quality or interruptions to supply. The distribution system leaked badly yet, there was little attempt to quantify just how much since the few flow meters that were installed were poorly maintained if at all. Spending on reticulation renewal was low and the legacy of aging pipes remains to this day.

But, in the years just prior to disaggregation in 1995, Melbourne Water underwent a swift down-sizing. The retrenchment of workers was not always handled sensitively and at least two long serving employees committed suicide after they lost their jobs. The widow of one of these successfully sued Melbourne Water and the presiding judge noted dryly that while the organisation had provided counselling for managers forced to retrench staff, there was no help for the sacked workers themselves. But the corporation rapidly became leaner and fitter as it primed itself for the most massive change in its history.

DISAGGREGATION

On 1 January 1995, Melbourne Water was broken up into one wholesale and three retail water companies. The break-up was undertaken with a view to privatising the retail water companies but that never eventuated as the notion became deeply unpopular with the general public and politicians. But the new structure was maintained as a means of “competition by comparison” overseen by the Essential Services Commission (ESC). After 12 years of operation, comparing the present four water companies to the previous monolithic Melbourne Water is like comparing Pegasus to an old farm horse. There have been improvements in every area from customer service to supply interruptions, from leakage reduction to capital works, from innovations to planning for the future. The number of excellence awards collectively won by Melbourne’s water businesses is affirmation enough. How much of these gains are the result of “competition by comparison” is debatable. The benefits of staff downsizing, scrutiny by a regulatory body, outsourcing of services by tender, and the greatly subdued role of the unions today would have been apparent even without a wholesaler-retailer split. But all these improvements must have been kick-started and accelerated by the creation of four new water businesses that were smaller, nimbler and eager to rise to the challenge of comparison. It gave impetus to the dramatic transformation of company culture whereas the baggage of the old Melbourne Water would have slowed or prevented change. These gains are unlikely to disappear any time soon, whatever the new retail structure, although a poor re-structuring could well result in their gradual erosion.

YOUR EXPERIENCE?

I would be happy to receive your experience with either management contracts, or with alternative ways of introducing commercial efficiencies into public service operations.

GREAT GRAPHICS!

This is the first in a series of presentation graphics that deserve more time and thought than is generally possible in the few seconds in which it is flashed up on the screen. It is reprinted here with permission of the author. If you should wish to use this graphic in your own work, please contact the author at the address at the bottom of this page.

The IAM cube



This graphic was presented by HELENA ALEGRE, in her opening address to the LESAM 2011 Conference in Mulheim, Germany, entitled Strategic Asset Management: still leading edge?“

If you would like to use this graphic in your own work, please contact Helena Alegre at halegre@lnec.pt