

OECD GLOBAL FORUM ON SUSTAINABLE DEVELOPMENT
PUBLIC-PRIVATE PARTNERSHIPS IN WATER SUPPLY AND SANITATION-
RECENT TRENDS AND NEW OPPORTUNITIES

*Cost Recovery Mechanisms: The Success of the National Water and Sewerage Corporation
and its Relevancy for Other African Countries.*

Paper Presented in November, 2006

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1. Introduction

Chairman, ladies and gentlemen, first of all, I would like to thank the organisers of this important 'Experts Meeting' for inviting me to come and share with you our experiences at NWSC and how these can be relevant in other African Water utilities.

Permit me to add my voice to all those who believe that a discussion on access to safe drinking water and sanitation in Africa is important and, particularly, thank those who have made it a thematic chapter of this year's **African Economic Outlook** (AEO). The low drinking water and sanitation coverage indicators of 58% and 36% respectively, for the sub-Saharan Africa, a region where my utility – NWSC is located, clearly underscore my view about the importance of this meeting!

Chairman, I have scanned through the objectives of this meeting and especially this particular session on 'financing access to drinking water and sanitation: what issues and actors'. I like the brief introductory analysis to the session and most importantly the conclusion, which alludes to the fact that the challenges to water supply and sanitation are varied and require institutional reforms to break the vicious circle.

My discussion will rotate around the topic, **"Cost recovery mechanisms: the successful case of NWSC-Uganda and its relevance for other African cities"**. But before I go into details of the real subject matter, let me present to you how far NWSC has gone towards achieving coverage – one of the pillar indicators of MDGs. Since 1998, NWSC has significantly improved water coverage from about 48% to about 70% as at 2006, an average increase of 2.8% per annum. At this rate, NWSC will achieve water coverage of about 85% by 2015, representing significant achievement of MDGs in this regard. However, due to extremely high investment requirements, sewerage coverage remains a significant challenge, stagnating at 8% (1998-2006).

2. Increasing Access to Drinking Water Requires Efforts, How Has NWSC Done It...?

One of the main performance drivers for achievement of water coverage indicator has been deliberate emphasis on cost recovery. Please note that I am not talking about achievement of full cost recovery but moving towards it. To elaborate on this, NWSC was posting a financial loss of US\$ 0.4M in 1998, but this has been consistently turned around to a surplus of US\$ 2.5M, after depreciation. For us..... this is positive progress towards full cost recovery frontier! Of course, this level of financial performance requires a sound operating framework. Since 1998, NWSC has implemented a number of change management programmes aimed at improving the organisational behaviour of staff, strengthening customer orientation, containing costs, enhancing technical and commercial performance through a number of incentives schemes and improving the public image. All the performance programmes were designed

within the overarching performance contract with Government. The details of change management programmes implemented and their evaluations can be found on NWSC-Website: www.nwsc.co.ug.

3. Making Progress Towards Cost Recovery...NWSC Mechanisms

My discussion of cost recovery is based on the understanding that it involves full coverage of O&M costs, depreciation, financing costs (relating to loan amortisation and interest payments) and return on capital employed or dividends to shareholders. **Worldwide, this is a difficult situation to achieve, in the water sector!!** A utility can only do its best towards achieving it depending on the operating environment (income levels, customer density, political support, regulatory/incentive regimes etc).

I now turn to practical recovery mechanisms at NWSC.... The main overarching cost recovery principle, like in any business, has been characterised by revenue maximisation, cost containment and tariff simplification/rationalisation. More specifically, the mechanisms we have used include the following:

- a) **Tariffs:** The NWSC tariff was last increased in 1994. In 2000 the corporation simplified its tariffs, reducing new connection and reconnection fees and introduced a nominal fixed service fee on top of consumption charges. These adjustments were carried out to improve customers' willingness and ability to pay for consumption and access. In 2002, the corporation introduced the tariff indexation policy, aimed at protecting the operating tariff against input price escalation resulting from inflation, foreign exchange costs and other external factors. This has helped to attain price stability, in real terms, which has in turn enhanced the Corporation's efforts towards cost recovery (financial sustainability).
- b) **Increasing Connections (Economies of Scale) through New Connection Policy:** In 2004, NWSC realised that the impediment to increasing market size and hence service coverage, especially for the poor, was payment for access. Consequently the corporation introduced free connection policy, up to 50m, from the water main. One of the enabling factors for the introduction of this policy was a slight adjustment in the consumption tariff for existing customers (about 10%) that went unnoticed! Of recent (2006) the same policy has been extended to the sewerage connections, up to a distance of 60m. The policy has helped to boost service coverage and cost recovery enhancement efforts, through increased new customer hook-ups.
- c) **Cost Containment and Revenue Maximisation Innovations:** Since 1998, NWSC has implemented a number of innovations aimed at minimising operating costs and maximising revenues. These were implemented through short-term commercialisation programmes, driven by well designed incentive schemes (both financial and emotional). In this regard, we take stern measures to any staff involved in illicit expenditure activities including transfer pricing. These programmes have also helped to drive the corporation towards improved cost recovery situation!
- d) **Specific Projects Grant Financing:** The NWSC has implemented a number of huge capital projects through donor grants. These are specific projects that are aimed at improving the corporation's technical ability to produce and supply water and sometimes provide sewerage services through modern and cost effective technologies. In this case, we agree with donors or development partners to carry out detailed project financial appraisals and analysis on assumption of payback of project funding and cost of capital. Example here include, KfW-funded projects of Fort Portal and Kabale where appropriate technologies had to be selected in such a way that financial viability was ensured, avoiding 'elephant'

projects. In other words, donors only intervene in projects that guarantee financial sustainability and cost recovery, covering O&M and depreciation costs.

- e) **Strict and Efficient Project Implementation Approaches:** The NWSC's Project Implementation Unit (PIU) is staffed with very competent staff, who work hand in hand with consultants to ensure cost-effective and efficient implementation of capital projects to avoid shoddy work and future high O&M costs. In addition, the PIU team guards against cost and time over-runs, which are the usual causes of high project costs that result into high depreciation. After project completion, we make sure that projects return immediate benefits through aggressive marketing efforts to increase new customer hook-ups and related timely billings. In so doing, revenues are realised immediately, which in turn enhances the cost recovery situation.
- f) **Government Commitment Versus Operational Commitments, pegged to structured incentives in the GoU/NWSC Contract:** In NWSC we have negotiated with government and agreed to reschedule the debt and eventually write it off. This has been done in exchange of a strict operational commitment plan towards re-investment of internally generated funds. The negotiation process also incorporates an incentive arrangement pegged to a number of deliverables within a performance contract between GoU and NWSC. In doing this, the corporation increases service coverage, without necessarily hiking the tariffs. This, in conjunction with good innovative operating practices, ensures continuous progress towards cost recovery and financial sustainability.

4. Achievements since 2003

As a result of implementation of the above cost recovery measures, the NWSC has registered a number of outputs, which include the following:

Year Ended 30 June	2003 Shs. m	2004 Shs. m	2005 Shs. m	2006 Shs. m
Income	37,141	42,618	53,778	58,540
Operating Expenses	(29,038)	(31,599)	(40,476)	(44,523)
Profit Before Depreciation	8,103	11,019	13,302	14,017
Profit After Depreciation	778	1,296	3,757	4,237
UFW: Kampala	44.5%	44.7%	40.6%	35.7%
Other Areas	26.7%	20.8%	16.8%	15.2%
Staff/1000 Water Connections	11	10	9	7
Service Coverage (Water)	63%	65%	68%	70%

5. In Conclusion

Ladies and gentlemen, we have learned that, for equitable service provision to all categories of people, especially the poor who are the majority, cost recovery continues to remain a myth, especially in developing countries. The challenge is how do we continue to improve service coverage, especially for sanitation, without significant increase of tariffs. In my view, the answer lies in ... **specific projects grant financing (for huge capital intensive projects) in tandem with continuous operating efficiency improvements.** National governments must continue to play a key role in this regard. BUT.....remember, you cannot move towards cost recovery, in a sustainable manner, when you are operating with a lot of inefficiencies. You must do your part and indeed let all of us do our part!

THANK YOU FOR LISTENING TO ME