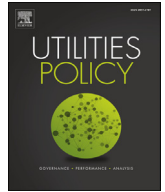




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Raising the bar: The role of governance in performance assessments

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ABSTRACT

On a worldwide basis, due to significant market failures in the water sector, there is a requirement to promote regulation. To attain balance in water sector's performance, bearing in mind the public interest, the use of performance assessment systems may become relevant to improve efficiency, mainly when utilities have public ownership. Here we posit the relevance of sunshine regulation and governance for quality of service improvements. For such purpose, an innovative performance assessment system, based on indicators, was proposed. We discuss its use in the Brazilian capital, Brasilia, particularly the role to be played by governance related indicators.

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1. Introduction

Performance assessment of water and wastewater services (WWS) can lead to high efficiency gains because the environment they operate in tends to be noncompetitive (Berg and Tschirhart, 1988). It is usually characterized by monopolistic features and by the presence of asymmetric information (moral hazard and adverse selection) which encourage rent seeking (making excess profits), a quiet life and X-inefficiency (De Witte and Marques, 2010). Moreover, the organizational culture of these utilities may be characterized by a lack of concern about customers, nonreactive bureaucratic systems, lack of transparency, and political interference (Marques and De Witte, 2010). This status quo which is typical of the absence of a competitive market can worsen when the ownership is public, like in government owned utilities (GOUs), since in theory there are no clear incentives to be efficient (Renzetti and Dupont, 2003). In the case of private water utilities, the shareholders' pressure and payments by results send messages to managers in the right way and inefficiency is somewhat eliminated (Vining and Boardman, 1992). Note that inefficiency corresponds to available resources that are neither used nor useful for anyone.

To create and mimic the market and to provide incentives for the utilities to become efficient, regulatory agencies are established (Marques, 2010). The main role of these watchdogs is frequently the

comparison of performance and of the economic efficiency of utilities, known as yardstick competition (Shleifer, 1985). One of its approaches is the so-called sunshine regulation (Marques, 2006). It corresponds to a simple computation, comparison and disclosing of performance, taking into account a performance assessment system (PAS). This name and shaming strategy imposes pressure to improve from different stakeholders (for example, users, media, and politicians). The entities with poor performance get 'embarrassed' and, consequently, tend to correct the failures detected (Marques and Simões, 2008). Although this method does not set tariffs and its coercive power is likely weak, significant improvements are found regarding quality of service aspects. Furthermore, conventional regulation may be insufficient in improving the performance of GOUs, as it does not address the governance problems that lie at the root of their problems (Ehrhardt and Janson, 2010). Thus, in this paper, we argue that sunshine regulation can be a very powerful tool for WWS regulators, particularly when they regulate GOUs or other public utilities and target governance as a key assessment objective. Sunshine regulation provides moderate incentives but it has high effectiveness potential, and quality of service along with governance are often major issues in water utilities (Corton and Berg, 2009; Kalulu and Hoko, 2010).

PAS included in the sunshine regulation takes into account a Performance Indicator (PI) system structured into several dimensions corresponding to different perspectives of performance analysis considering different PIs. Note that these metrics are quantified measures that translate the way or the intensity by which a given activity is accomplished in the form of ratio.

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In this article, by using the empirical and real-world case study of Brasilia, in Brazil, we propose a standard regulatory model based on sunshine regulation as a way to improve performance and provide value for money in water utilities. ADASA (Regulatory Agency for Water, Energy, Wastewater, Waste, and Drainage of Distrito Federal) is the water regulator of Brasilia, regulating a government-owned company, CAESB, which is responsible for the drinking water supply and wastewater collection and treatment of about 3,0 million inhabitants in the Brazilian capital. For this purpose, a PAS was developed considering for the first time in the PI system a dimension of governance as one of the pillars of performance analysis. The methodology proposed was introduced in late 2016, however, it is still at an implementation phase. After this brief introduction, the remainder of this paper is as follows. Section 2 describes the status quo of PI systems and situates the paper in the current literature. Section 3 tailors a requisite PI system. Section 4 describes and discusses the case study and finally, in Section 5, concluding remarks and policy conclusions are drawn.

2. Regulation and performance

2.1. Governance and regulatory substance

The WWS nature (as the presence of natural monopoly characteristics that leads to market failures) and the need to counter raising challenges led governments to seek private investment and public trust. Those were, perhaps, the main motives that thrived the implementation of some sort of regulation either by contract or by agency or even a mix of both (Jensen and Wu, 2016).

The selection of the best option to target market failures among the possible mechanisms (e.g., type of regulations) is rarely clear-cut. It should be framed considering the inherent complexity as well as the ability of the state apparatus to monitor and implement tools and rules (Cuervo-Cazurra et al., 2014).

The perceived clash between public interests and the profit motive drove the establishment and implementation of a whole set of specific rules, needed to attain balance in WWS performance under private participation, capturing efficiencies, fiscal prudence and credible commitment. The acceptance of such assumptions led to the awareness that it could be a possibility to reconcile social and commercial functions, improving the performance of under-performing GOUs (Furlong, 2015). The idea was to capture the private virtues of efficiency, innovation and the 'publicly-owned non-profit' legitimacy (Leong and Li, 2017).

The instruments available (tools and rules) and the substance of regulation vary greatly from case to case, covering licensing facilities, performance standards (quality), performance monitoring, prices and price structures, uniform accounting system, dispute resolution, management audits, and efficiency incentives. A key issue (that arises from the listing of instruments) is that of external (e.g., enforced by the regulator) or internal (promoted by the utility) sanctions and incentives. In some cases, it might be not possible by law to promote those sanctions and incentives in GOUs.¹ Furthermore, for GOUs, economic or financial (external) sanctions and incentives are often perceived as ineffective. In fact, most traditional economic regulations when applied to GOUs lose their connection to the efficiency counterpart, as ultimately, the onus is passed to the tax payers (for further advantages and disadvantages of traditional regulations, such as price/revenue caps and rate of return, please see Frontier Economics, 2014). In the selection of

regulations, decision makers have to consider that some are painful and costly processes that do not necessarily lead to the best outcomes for customers or companies or regulators (as highlighted by Littlechild, 2014; for price controls).

These points underscore the extent to which governance, policy, and regulatory mechanisms should be separated for GOUs. Under a unitary system, coordination is facilitated as governments direct the utilities they own to achieve stated objectives. Regulation, ownership, and policy are all handled within the same basket, with the relationship between regulatory officers, government officials and utility managers determined through the formal arrangements specified in law (or executive orders) and informal relationships among the various participants. If, at best, those conditions may provide the desired results, when those interactions are heavily based on political relationships, there is an inevitable fuzziness over the boundary between policy (primarily for Government) and implementation (for regulators), the result is likely to be muddle (Bolt, 2014). Groom et al. (2006) specified the selective choice of priorities (with the poor, rural areas or marginal groups being on the short end); short-termism (political aims may result in below-cost recovery tariffs and financially unsustainable utilities); capture for personal ends (facilitated by the non-transparency of operating decisions); and provider capture (where utility managers in the interest of specific stakeholders).

A balanced performance is ultimately what is desired. However, it depends on several dimensions linked to structural features (endogenous) and institutional forces (exogenous). Beecher (2013) defines the former through 'ownership form', 'practice standards', and 'enterprise autonomy', and the latter through 'market contestability', 'external review', and 'economic regulation'. In a straightforward fashion, a change in ownership may have a good impact, or a bad one, as what matters to performance, both theoretically and practically, is 'governance' under the previously mentioned dimensions. Thus, as Beecher (2013) states: "a pragmatic approach to reform is to strengthen core governance capacities in relation to performance priorities, which ultimately matter most of all".

Considering the scope of this paper, we will focus on the regulatory application of PI systems, namely under sunshine regulation, where they are covered by a broader benchmarking process (Berg, 2013). The inclusion of a governance dimension, with both corporate and sectoral features, in such a context can be vital to all stakeholders. The former is not micro-management, but a way to 'document whether the utility is utilizing best practices' or 'following what was set in management plans'. A proper mix of both types of governance would allow to evaluate the system's performance in a broader sustainable perspective, promoting efficiency and innovation resulting in improved public confidence and inclusiveness (Marques and Pinto, 2017). Such achievement of legitimacy and sense of fairness affects conflict resolution among stakeholders, requiring managers to respond to citizen complaints, holding them accountable for cost containment and service quality allowing an increased acceptance of outcomes. The other end of the spectrum leads to worsened problems (Akhmouch and Correia, 2016). While far more PI systems have run on a platform of strict operational performance measurement than on governance, the latter deserves to be highlighted.

In practice, it is important to highlight that results are not immediate and are most probably not promptly tangible. The role of establishing some governance measurements is thus paramount to achieve the desired outcomes, or at least to preserve a continuous improvement trend (Marques et al., 2016). Indeed, improving governance is the basis for developing better incentives to foster efficiency, and at least, as Berg (2016) puts it: "if the process is transparent, stakeholders (including political leaders) will better

¹ The incentives/sanctions issue is very relevant for performance, nonetheless it goes beyond the scope of this paper. Please, see Groom et al. (2006), Mugisha (2011), Berg (2013), and Leong and Li (2017) for further insights/case studies.

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