

# **Manila Water Company, Inc:**

## **A Case Study on Private-Public Partnership**

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### **Overview of the MWSS Privatization**

In 1997, the Philippine Government privatized Metropolitan Waterworks and Sewerage System (MWSS), a public utility engaged in the provision of water supply and sanitation services for Metro Manila's nearly 10 million population. The International Finance Corporation (IFC) played a key advisory role and described the program as the "biggest water privatization in the world".

Through private sector participation, the MWSS privatization was expected to result in the expansion of the service coverage, improvement in the quality of service delivery and increase in operating efficiency particularly the reduction of Non-Revenue Water (NRW).

The privatization structure entailed auctioning two 25-year concessions through competitive bidding and giving the winning bidders the responsibility to handle water treatment, distribution, tariff collection, facility improvement and overall management. Strong private sector was shown by the participation of major players in the global water industry like Vivendi, Ondeo, Anglian and United Utilities as well as leading conglomerates in the Philippines like Ayala Corporation, Metro Pacific Corporation, Aboitiz Corporation, and Benpres Holdings of the Lopez Group.

The winning consortia, Ayala-led Manila Water Company and Lopez-led Maynilad Water Services, took over the operation and maintenance of MWSS on August 1, 1997.

### **Business Strategy**

Manila Water has posted significant gains, notwithstanding external shocks in the last six years. Despite the Asian financial crisis in 1997 and the El Niño phenomenon in 1998, the company managed to pull through and posted significant achievements in fiscal prudence and various operating efficiency measures.

The strategy that Manila Water implemented since 1997 has several elements, namely:

## *Corporate Transformation*

The company developed a new corporate philosophy (“We Care”) which is essentially geared towards enhancing customer focus and employee empowerment. Instilling trust and confidence in former public employees was an important hallmark of this philosophy since the company continues to depend on these employees, constituting 95% of its workforce of about 1,500 personnel. As a result this new “culture”, the employees of Manila Water posted significant gains in efficiency and garnered prestigious awards on productivity and quality. Furthermore, the reduction in the number of employees from 2,200 to its present level of 1,500 was successfully implemented through a series of voluntary early retirement programs. The same employees hold 6% of the company’s share capital through an Employee Stock Option Plan.

## *Focus on Customer Service*

To sustain its customer focus, the company established seven Business Areas each servicing the needs of about 60 to 70 thousand households. Each Business Area is further subdivided smaller hydraulic territories or blocks called Demand Monitoring Zones (DMZ) which is managed by a Territory Team with focus on water supply and demand, NRW monitoring and control, and customer service.

To further improve service level, Manila Water spent nearly US\$200 million over the past six years for rehabilitation of key primary mains (over 200 kilometers) and expansion of the capacity of its pumping stations. Coupled with strong customer focus, these investments resulted in the following accomplishments:

- § Increased billed volume from 440 million liters per day (mld) in August 1997 to nearly 760mld in July 2003, an increase of more than 70%;
- § Provided water supply to about one million people nearly half of which would represent the urban poor;
- § Reduced NRW from 63% in August 1997 to 54% in end of 2002. As of July 2003, the NRW level is down to 51.6%;
- § Improved water availability (i.e., customer receiving 24 hour supply) from 27% of those connected to the Central Distribution Network to nearly 85% as of June 2003 (please see Attachment); and
- § Exceeded water quality standards<sup>[1]</sup> imposed by the Department of Health.

	1997	1998	1999	2000	2001	2002
Estimated served population <sup>[2]</sup> (of which urban poor <sup>[3]</sup> )	3,000 (9)	3,100 (82)	3,600 (166)	3,800 (300)	3,900 (380)	4,300 (500)

Staff per 1,000 connections <sup>[4]</sup>	6.3	5.11	4.75	3.8	3.6	3.2
Total Operating Cost <sup>[5]</sup>	5.95	5.47	5.21	4.77	4.73	4.89
Average consumption <sup>[6]</sup>	23	55	59	60	62	63

### ***Bias for the Urban Poor***

To ensure sustainability of its concession, Manila Water has focused on extending water supply services to low-income and informal communities in its concession area through its “Tubig para sa Barangay” (i.e., water for the community) projects. People living in depressed communities usually get their water from contaminated sources or pay a steep price of P200 per cubic meter from water vendors. The program has enabled the socially disadvantaged sectors of society to obtain water connections at affordable rates, reducing the cost per cubic meter of water by as much as 97%. Since 1997, over 300 projects under the program were completed in key cities in the East Zone benefiting over 80,000 households or 500,000 people. Through the program, the Company has minimized illegal connections, leaks, and the incidence of water contamination. Moreover, the program has improved the quality of life of the poor and forged excellent community partnerships.

### ***Tariff and Regulatory Support***

The company effectively managed regulatory risks and challenges including resolution of a dispute through international arbitration and the successful outcome of the rate rebasing or price review in 2003.

While the company continues to face foreign exchange risks<sup>[7]</sup>, it is now in a much better position to address these through an automatic, revenue-neutral tariff adjustment mechanism.

The regulator supported the new business plan submitted by Manila Water through an appropriate two-tier tariff adjustment. While the company’s tariff rates have gone up from Pesos 4.02 per cubic meter at the start of the concession in August 1997 to about Pesos 13.38, this still compares favorably with estimated rates of Pesos 18-19 had the privatization of MWSS did not take place. Adjusting by the prevailing exchange rate of Pesos 55 per US dollar, the rates of Manila Water at US\$0.24 would still be one of the lowest in South East Asia.

### ***Creditor Support***

Coupled with favorable performance and efficiency indicators, Manila Water was also successful in getting the support of its local and foreign creditors which now includes the German Development Bank (GED) and the World Bank’s International Finance Corporation (IFC). The Company increased its

cumulative borrowings from US\$25 million in 1999 to about US\$130 million in 2003.

### *Environment and Social Development*

The company continues to look for ways to provide better sewerage and sanitation services to its customers. It is now constructing 23 low-cost, decentralized package septage treatment plants as well as aggressively rolling-out sanitation services (i.e., cleaning of septic tanks and proper disposal of sludge) to comply with its service obligations. Its sanitation program is supported by the Asian Development Bank and the World Bank.

In coordination with MWSS, the company is looking for new ways to protect the Angat and La Mesa watersheds which provide 95% of Manila's raw water supply.

## **Financial Performance**

The financial performance of the company improved steadily in the last five years, from a net loss in 1997 to Pesos 553 million profit in 2002. The net losses of about Pesos 100 million in 1997 and 1998 were due largely to the impact of the El Niño phenomenon and the Asian financial crisis<sup>[8]</sup> in 1997 to 1998 which increased debt servicing of loans (about US\$200 million) that the company absorbed from MWSS.

Total annual revenues<sup>[9]</sup> consistently increased from Pesos 960 million in 1998 to Pesos 2,523 million in 2002, buoyed by NRW gains. Through fiscal discipline, total operating expenses were controlled since 1997.

For the first six months of 2003, Manila Water posted Pesos 620 million on revenues of Pesos 1,700 million.

### *Selected Operating and Financial Indicators*

In million pesos unless otherwise indicated	1997 (5 mos.)	1998	1999	2000	2001	2002	2003 (6 mos.)
Billed Volume <sup>[10]</sup>	498	516	613	683	733	747	760
NRW (%)	58.0%	49.0%	53.0%	51.0%	53.2%	54%	51.7%
Average Tariff <sup>[11]</sup>	4.02	4.02	4.37	4.55	6.31	9.37	13.38
Revenues	416	960	1,295	1,401	1,565	2,523	1,700
EBITDA	(37)	(57)	186	225	304	1,132	940
Net Income	(38)	(67)	100	123	176	553	620

Source: 1997 to 2002 data: MWCI Audited Financial Statements. 2003 data: MWCI unaudited Financial Statements

# Technical Evaluation Report<sup>[12]</sup> on Manila Water Company

In 2002, the MWSS Regulatory Office conducted an evaluation of the performance of Manila Water during the period 1997 to 2001 as well as the 2003-2022 business plan it submitted. The evaluation was a critical step of the 2003 “rate rebasing” framework set in the contract. The University of the Philippines Economics Foundation, Inc. and Thames Water International Services Ltd. served as consultants of the MWSS Regulatory Office in assessing the performance of the company in improving and expanding water and sanitation services in its service area. The key findings of the consultants are outlined below:

## 1. “Efficient operator”

“Manila Water was a relatively efficient operator during the past 5 years and substantially complied with its service obligations”.

## 2. “Improve[d] service coverage,” “improved water availability”

“MWCI outperformed the connections stated in the bid model... Manila Water over the last five years increased the investment in tertiary and primary systems building up the network capacity to improve service coverage from 67% to 89%, improved water availability from 26% to 83% with 24 hour supply, network pressure increased. The average billed volume increased by 71% in the past 5 years.”

## 3. “Proactive in approach to sewerage and sanitation”

“MWCI has been proactive in their approach to Sewerage and Sanitation and an attempt has been made to overcome a number of setbacks and constraints encountered. The way forward has been thought out logically and has every opportunity of being successful.”

## 4. “Successfully downsized costs”

“MWCI successfully downsized the concession by reducing the workforce by 25% within three years of operations. Company culture initiatives have been introduced. Technology has been introduced at a sensible level. Logistics have been thought out. Employee costs are lower than the West Concession. The employees have accepted flexibility and ownership. Quality circles and project teams have been set up to improve efficiency. A commercial customer-driven work environment has been created. The change process is managed and being led by example. A strong base has been established for going forward.”

## 5. "Prudent and efficient"

"Overall, MWCI has succeeded in operating reasonably well, within the spend profile of the Bid Proposal, for the first five years of the concession. Based on information obtained during the rebasing exercise, there is every reason to believe their performance will continue over the next five years in a prudent and efficient manner."

In order to further improve the evaluation and monitoring of the performance of Manila Water in light of the next rate rebasing scheduled in 2008, the regulator and its consultants proposed a "Penalty and Reward" system broken down as follows:

- § Key Performance Indicators (KPI) focuses on delivery of water, sanitation and customers services.
- § Business Efficiency Measures (BEM) includes income, operating expenditures, capital expenditures and non-revenue water (NRW).

In the next rate rebasing in 2008, the regulator will evaluate the performance of Manila Water against these KPIs and BEMs, quantify the company's performance in the form of financial reward or penalty and include it as part of the Opening Cash Position which forms the basis for setting future tariffs.

## **Successful 2003 Price Review**

In October 2001, the MWSS and its Regulatory Office conducted a price review or rate rebasing. Manila Water prepared a new business plan which was reviewed by the team of consultants engaged by the regulator.

The regulator completed its year long review which resulted in a rate adjustment of over 70%, the implementation of which will be staggered between 2003 and 2005. As result, the tariff rate for non-sewered customer has gone up from Pesos 9.37 per cubic meter (~US\$0.17 @ P54.5/\$ exchange rate) by the end-2002 to Pesos 13.38 (~US\$0.24) as of June 2003. By January 2005, the rate will be about Pesos 16.61 per cubic meter. (~US\$0.30). While the adjustments are quite substantial, the water bills of the average residential customers remains below 3% of their income.

The successful rate rebasing of the company could be attributed to the following factors:

- § Efficiency gains and improvement in service over the past 6 years;
- § Comprehensive business and capital investment plan worth US\$ 1 billion over the period 2003 to 2022 to address expansion of water

coverage and sanitation services with particular focus on the urban poor;

§ Effective relationship with MWSS and flexibility in negotiating with regulators;

§ Strong support of communities and local government units;

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Manila Water faced significant challenges and external shocks since 1997. However, the company still recorded marked gains in service delivery and billed volume. It connected more than 500,000 poor people during the period.

The profitability of the company has significantly improved through successful corporate transformation, business expansion, fiscal discipline and effective management of regulatory relations resulting in the implementation of appropriate tariff adjustments. For 2003, the company expects to post its best financial performance so far with first semester profits already exceeding the 2002 level!

The company is now laying the groundwork for the listing of its shares through an Initial Public Offering in the local exchange. Barring any significant downturn in the macro-economy, a successful listing of the company shares will be a significant milestone for water concession projects in developing countries.

Moving forward, Manila Water remains focused and confident that it will address the new challenges of expanding the network to meet the needs of a growing population, rising customer expectations on service level and new regulatory targets on efficiency.

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[1] These are consistent with standards set by the World Health Organization.

[2] In thousands. Since Metro Manila is densely populated with over 12 million people, Manila Water used a multiplier of 9.2 people per household connection to estimate the equivalent population served. This multiplier was used by SOGREAH, a French engineering consulting firm, in 1996 as basis for the MWSS privatization study.

[\[3\]](#) Based on actual field reports of “territory managers” of Manila Water, water service connections to low-income areas are normally shared by multiple families or households. MWSS provided public faucets and supply projects for the poor. However, the beneficiaries of these projects were not recorded or quantified.

[\[4\]](#) Per household connections.

[\[5\]](#) Per cubic meter of billed water. Excludes interest expense, depreciation and amortization. Prior to privatization, MWSS operating cost hovered around Pesos 11-12 per cubic meter.

[\[6\]](#) Monthly average consumption in cubic meters.

[\[7\]](#) Revenues of the company are based on local currency while all its borrowings and debt service are denominated in foreign currencies.

[\[8\]](#) The Asian financial crisis resulted in marked depreciation of the Peso from Pesos 26 per US dollar in June 1997 to over Pesos 50 in 1998. As of the writing of this report, the value of the local currency is about Pesos 55 to the US dollar.

[\[9\]](#) Based on billed volumes. Manila Water collects 95% of its billings on average.

[\[10\]](#) In million liters per day

[\[11\]](#) Average all-in tariff per cubic meter at year-end for non-sewered, residential customer. Commercial and Industrial customers pay disproportionately (i.e., cross subsidy for residential customers) higher rates under MWSS’ increasing block tariff mechanism.

[\[12\]](#) Technical Evaluation Main Report. Thames Water International Services Ltd. and University of the Philippines Economics Foundation, June 2002