



Water Integrity Brief

Providing a concise overview of specific themes related to water integrity

Private sector

Water integrity: an opportunity for the private sector

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BACKGROUND

This Water Integrity Brief highlights integrity risks and opportunities linked to private engagement in water supply and wastewater management, it does not address water resources management. To reduce corruption and enable better management in the water sector, it is essential that all actors join the effort to promote water integrity. Among the sector's biggest consumers, investors and service providers are private companies. As key players, they have a strong voice in decision-making processes. Alongside multinational companies, small and medium-sized enterprises play an important role in the supply of water, as well as wastewater and water resources management. Beyond direct engagement in service provision and management, the water sector also depends on the private sector for construction, engineering, research and advisory services. Companies are often seen as the 'supply side' of corruption, paying bribes or initiating corrupt acts such as collusion, yet they are also its victims, suffering when competitors bribe and collude with public officials. This is because private actors in the water sector are both drivers of corruption and affected by it (Nadgrodkiewicz, 2008), (TI, 2012). The private sector needs to be involved by governments and civil society as a key partner in fighting corruption and building trust.

PRIVATE COMPANIES' ROLE IN WATER SUPPLY AND WASTEWATER MANAGEMENT

For water supply and wastewater management, a range of services and equipment are needed from the private sector to develop infrastructure and build knowledge and capacities. The private sector also



Services from construction and engineering companies are essential for the sector
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plays a crucial role by supplying water and wastewater services directly to a large percentage of people. According to estimates, at least 909 million people received water services from the private sector to some extent in 2011 (Pinsent Masons 2011).

Privatisation of water and wastewater services occurs mainly through:

1. Operations and maintenance or lease contracts, which delegate full financial responsibility to the private operator.
2. Concessions involving the private sector for operation of assets in order to pay for new facilities and upgrading work (these comprise the provision of specific or all services).
3. Sale to a private company of utilities assets, together with the licence to operate them.

The timescales, degree of asset ownership, and responsibilities for investment and tariff collection vary across these types of privatisation. In addition to these 'traditional' approaches to privatisation, a trend can

be observed in countries such as Kenya, Tanzania and Zambia to commercialise publicly-owned water utilities and operate them on a not-for-profit basis. This approach introduces some of the benefits of the private sector, such as efficiency and productivity, and allows staff to assume a clearer responsibility for results (Richards et al. 2008).

Whether handled through private, commercialised or public utilities, engagement of private actors in the form of consultancies, engineering and construction companies is essential for water supply and wastewater management. Their involvement spans major projects, such as design and construction of supply networks and treatment plants, through to project financing or carrying out studies and training.

While public attention is mainly directed at the engagement of large multinational companies, small and medium-sized enterprises (SMEs) also provide a wide range of services and products to the water sector. These include development of technical solutions for specific problems in the sector, the supply of equipment, advisory and consulting services for decision-makers, and operation of water systems in small towns. In several countries – including Ecuador, Kenya, Mozambique and the Philippines – local private entrepreneurs are contracted by public utilities to supply water to low-income peri-urban areas (Norman et al. 2011).

The private sector's involvement in water infrastructure development, operational management and service provision enable it to contribute innovations, technical expertise and financial resources to the sector. It is therefore important to tap into the benefits of private sector involvement in order to achieve more effective management and meet development goals such as the human rights to water and sanitation. However, given the private sector's profit-oriented nature, several challenges with regard to integrity may arise when it comes to decisions that can affect both the public interest and a company's revenues. Like other stakeholders, a private supplier or construction company might seek to shape policy in its favour. Such challenges are not always specific to the participation of private actors (lobbying, policy capture and corruption occur under public provision as well), but they make it more difficult to design and enforce structures for good governance (World Bank, 2006). The regulatory framework and assertiveness of oversight agencies are therefore crucial to ensure that private engagement in water supply and wastewater management benefits the public interest and in particular meets the needs of the poor.

CORRUPTION RISKS IN PRIVATE SECTOR ENGAGEMENT

“Private investment in water is growing in countries already known to have high risks of corruption”

As private sector investment is increasing in countries perceived to be highly corrupt, the private sector will also be increasingly exposed to risks of corruption. These risks are most likely to occur in the interaction between companies and public sector institutions, where various factors increase the likelihood of corruption. However, sub-contracting between private companies is also prone to corruption (TI, 2008, and, WIN & TI, 2010). Public water-sector authorities are natural monopolies responsible for projects with high initial capital costs and increasing rehabilitation costs, managed by officials with great discretionary power. Large amounts of money for investments can be seen as lucrative opportunities for corrupt public officials. Lobbying initiatives and political clout can give them undue influence on public policy ('policy capture'), while a lack of transparency in procurement makes oversight difficult. Risks of policy and regulatory capture increase in the context of developing countries 'because of relatively weak civil society oversight or other accountability mechanisms (e.g. tenacious media or select committee scrutiny), relative weakness of water ministries and their agents compared to ministries of industry and trade, and the absence of data or capacity to counter convincing corporate analysis' (Hepworth 2012).

The technical nature of the water sector, where companies with highly skilled staff engage with public authorities that are frequently understaffed and lack adequate capacities, results in significant asymmetry of information. The technical complexity inherent to designing and constructing water infrastructure makes it difficult for public officials to negotiate contracts or identify technical deficiencies in bids for infrastructure and other projects. Companies can abuse this lack of capacity, using their technical knowledge to manipulate contract specifications or the quality of work required, in order to increase their returns. In addition, it is difficult for third parties such as journalists to gain sufficient understanding and insight to detect corrupt practices at the interface between the public and private sectors (Jacobson et al. 2010).

While different types of corruption (from regulatory capture to tampering with water meters) can be found among both public and private actors, the nature of the private sector – whether private operators, construction companies or consultancies – brings a number of complexities that can result in additional integrity challenges (see [Box 1](#)).

BOX 1 Water integrity challenges from private engagement

- » The accountability of private actors is clearly linked to understanding and satisfying customer needs and meeting the obligations set by clients and regulators (TI 2008). Yet private actors must also ensure returns to investors and owners. Depending on the country of constitution, company law tends to elevate the interests of the company and its shareholders above those of stakeholders and the environment (Hepworth 2012). This increases the risk that companies will compromise equity and integrity considerations to boost their profit.
- » In many countries, the public has a right to access information from public authorities (e.g. the Indian Right to Information Act), a right which extends to public services related to water provision and water resources management. However, most freedom of information laws exclude the private sector from their jurisdiction. This lack of a legal framework to access information from private companies involved in the water sector can make it difficult for the public to fulfil its role in holding decision-makers and companies to account.
- » Needs assessments, technical project design, and accounting, auditing and similar tasks closely linked to decision-making processes are usually contracted to private companies. The dependence of some companies on public contracts creates risks of collusion between the contracting authority and the contractor to legitimise decisions or to cover up misuse of entrusted power.

Most public policy decisions require contracting activities for their implementation. As one of the main links between public officials and private actors in the water sector, public contracting is among the key areas of concern. Contracting procedures pose a high corruption risk because they are often complex and of limited transparency, making corrupt manipulation hard to detect (WIN & TI, 2010). There is also a need to differentiate between what might be called fiscal corruption and 'moral' corruption, in which bidders abuse the tender process by submitting a loss-leading bid in anticipation of a successful re-negotiation procedure afterwards (Pinsent Masons 2011).

Although contracted private actors more commonly occupy the 'supply side' of corruption, meaning that they provide benefits (bribes, gifts, etc.), there are also situations in which private actors collude with public officials and are rewarded with contracts – for example, by jointly manipulating the results of studies (such as feasibility studies or environmental impact assessments) that facilitate specific political decisions. Officials awarding contracts may also be involved with companies applying for those same contracts, or even own them. The early and late stages of the procurement process are most likely to be exposed to corruption, although it can occur at all contracting stages (see Figure 1). Key factors for increased corruption risks in public contracting include:

- Limited or restricted access to information
- Deficient safeguards and lack of transparency during the budget phase
- Lack of information and stakeholder participation at the planning stage
- Abuse of exceptions to open public bidding
- Limited or ineffective control and monitoring within the contracting process, particularly during the contract execution phase (Wiehen et al., 2006).

While large private water and wastewater service providers and construction companies draw much attention in the debate about private engagement in the water sector, it is important to recognise that SMEs are equally involved and face many corruption risks. Some of the more important integrity challenges for both large companies and SMEs are described below.

Large private water operators and construction companies – 'grand corruption'

Opening infrastructure service concessions to private operators can create incentives for corruption. A corrupt firm may pay to be included in the list of qualified bidders, to have officials structure bidding specifications so it is the only qualified supplier, or to be selected as the winning contractor. Once selected, it may charge inflated prices, compromise on quality or bribe public officials to cover up non-compliance with contract agreements (Rose-Ackermann, 1996).

Owing to their magnitude, large-scale projects are often highly organised, already containing the technical resources for their implementation. They are often carried out in contexts where implementing and control institutions are relatively strong (WIN & TI, 2010). This makes corruption more difficult to hide and

FIGURE 1 Contracting process



makes ‘grand corruption’ – involving a relatively small number of individuals but large amounts of money and the abuse of discretionary power – the most significant risk. Corruption may extend to such high level of administration that national policy is influenced. This in turn encourages decision-making by corrupt officials that favours activities providing the most potential for further corruption. For example, large and expensive infrastructure investments may be deliberately preferred in policy over smaller, decentralised systems and lower-cost technologies [Butterworth et al. 2009].

Two of the most prominent corruption cases are the privatisation of Grenoble’s water supply in 1987 and the Lesotho Highlands project in 1999. In Grenoble, 19 million Francs (around €2.9 million) were paid to obtain the concession for the city’s water supply, and subsequently used for financing election campaigns and other political activities. The Lesotho Highlands project brought to light large-scale bribery in international business transactions. Both cases drew significant attention, as senior officials and the companies involved were prosecuted and convicted. Both were partly attributed to bulk contracts, which were commonly given to private consortia in the late 1990s and early 2000s – popularly considered the ‘concessions era’ [Stålgren, 2006] [Barlow et al. 2002]. Another, less direct, type of corruption reported

from the same period involves feasibility studies for the privatisation of water supply and wastewater management. These were sometimes carried out by subsidiaries of international service providers and therefore did not sufficiently consider the interests of governments or the public [Richards et al. 2008].

Over the last decade, a shift to smaller management contracts, signed with several different companies, has been observed (in place of bundles of contracts given to one consortium). This disaggregation has to some extent helped reduce risks of large-scale corruption, but these management contracts are still vulnerable. Companies are most likely to pay bribes in public works contracts and construction, which are typical water sector investments [Hardon et al. 2011] [TI, 2012].

In terms of private water operators, large utility companies are often in a position to award lucrative contracts which may tempt third parties to bend the rules to get ahead of the competition. Such a scenario lay at the heart of an investigation by the economic regulator of England and Wales into a private water company in 2009. It was alleged that a sub-contractor had bought gifts for the company’s employees to secure profitable contracts. The case was brought to the attention of the regulator by the management of the company itself – showing that corruption is not only used by companies to win tenders, but can also become an internal problem which they may not be able to cope with by themselves.

Despite such cases of corruption, there have also been incidents of successful prosecution, which can act as a deterrent when made public. One such example is Severn Trent, the United Kingdom’s second-largest water company, which became immersed in a corruption scandal over misleading the industry regulator and manipulating figures supplied to the regulator to fatten its profits. As a consequence, the company was prosecuted and found guilty in two court cases. In response, it underwent comprehensive reforms to improve its cultural values (see Box 2) [Pagnamenta, 2009].



Water supply and wastewater treatment relies on equipment from private suppliers
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BOX 2 The Severn Trent corruption scandal and reforms

In 2004, an employee of Severn Trent invoked the company's whistleblowing procedure to protest at being instructed by his superiors to manipulate performance data in order to misrepresent the company's performance to the regulator.

As a result, in July 2008, Severn Trent became the first utility company in the UK to be prosecuted. The Serious Fraud Office accused the company's water division of providing false information to the regulator with respect to its operational performance data over a five-year period. This was described in court as a 'sustained and successful campaign of dishonesty'. Severn Trent pleaded guilty, and was fined £2 million, on top of an earlier £35.8 million fine in April 2008, for deceitful reporting in its Customer Service department.

In 2006, responding to the findings of an internal investigation, the board had seen the need to tackle processes, behaviours and values to prevent 'anything like this happening again'. Backed by active communication from senior management to employees about what had happened, the resulting reforms comprised:

- Ethics training for employees;
- Leadership development emphasising ethics and honesty;
- A revised code of conduct and whistleblowing policy;
- Tighter financial controls and clearer lines of responsibility and accountability;
- A more transparent corporate governance structure;
- Building employees' capacities to take more responsibility;
- A set of performance indicators to link each board member's work explicitly to the firm's performance and values.

In 2009, partly in recognition of the company's progress in recovering its reputation, Severn Trent was named 'Utility of the Year' by industry peers.

Source: Dietz et al. 2012

Small and medium-sized enterprises

Businesses are generally subject to more laws and regulations than individual citizens, and these complex

legal requirements unavoidably create potential for abuse (Nadgrodkiewicz, 2008). Yet when it comes to corruption risks, SMEs present a different set of issues from large companies. SMEs often have a weaker negotiating position and fewer legal options. Staff and financial constraints can also make it more difficult for smaller companies to implement anti-corruption measures and restrain from paying bribes to speed up work-related processes (e.g. to get a work permit or water licence). These factors make SMEs vulnerable to corruption, as has been confirmed in survey-based analysis, which concluded that 'strong firms use their influence to bend laws and regulations, whereas weak firms pay bribes to mitigate the costs of government intervention' (Benson et al. 2009).

SMEs are usually dependent on a few contracts or clients. Their higher financial reliance on single projects makes them easy prey for corrupt officials and can also make them useful allies when it comes to politically motivated decisions about water – e.g. in the implementation of studies which form the basis for decision-making or evaluating water-sector programmes. When a political interest exists in taking specific decisions (e.g. to build water infrastructure in a particular area in order to obtain votes) or when there is an interest in covering up the poor performance of a sector programme, the contractor and the contracting agency may collude over study results. SMEs with high financial uncertainty may be more willing to agree to this type of collusion in order to obtain a contract.

Beyond collusion and the payment of bribes, other forms of corruption affect SMEs in the water sector. In a survey of private water operators in Uganda, more than half the respondents reported that political interference was very common in the selection of private service providers. Among other issues, the survey also showed that payment of favours to management is a factor when it comes to staff promotion or that management is frequently aware that customers pay bribes to get their problems solved. This shows that the management of SMEs often lacks sound mechanisms to avoid corrupt practices (GoU, 2009).

INCREASING THE INTEGRITY OF PRIVATE ENGAGEMENT

To minimise corruption risks, it is important to set up an overall governance framework that ensures high levels of integrity in private sector engagement in water supply, sanitation and water resources management. Public authorities are largely responsible for generating the 'demand side' of corruption (e.g. originating the demands for bribery or kickbacks), yet

they cannot tackle complex governance challenges alone. The private sector – generally considered the ‘supply side’ of corruption (Nadgrodkiewicz, 2008) – also needs to promote integrity actively and contribute to curbing corruption.

Setting a level playing field: clear and reliable regulation

All reviewed studies on private-sector participation place a strong emphasis on the quality of regulation as a prerequisite for success or failure. A transparent, clear and reliable regulatory framework is considered the overarching mechanism that allows for better investment decisions. This can prevent corruption and improve integrity both for enterprises with their core business in the water sector and for companies using water as a resource (Pokorski, 2012). To achieve this, regulations must be enforced effectively, providing the regulator with authority in tariff setting processes and licensing, and establishing sound public reporting on good and poor performers. Beyond addressing private engagement, such regulations play an important role in fostering transparency, participation and accountability in the water sector as a whole (Boehm 2011).

The regulatory authority plays a key role in oversight and in setting the rules for all players in the water sector, thereby helping prevent corruption. In order to increase transparency and access to information (which may be more difficult with regard to private companies), it is important that the regulator shares information about the sector with the public, in such a way that it can be used to hold decision-makers and utility managers to account. Regulatory mechanisms such as benchmarking compel companies to be accountable for the services they provide and set incentives to improve performance. The regulator can also aim at actively fostering user participation – through national consumer councils, local consumer groups and involvement in price-setting processes – and monitoring the way complaints are handled. Such mechanisms are likely to reduce the scope for petty corruption, e.g. related to connections and repair work (Boehm 2011).

While many such regulatory mechanisms implicitly deal with corruption risks, an explicit anti-corruption agenda is often not present. It is therefore important to explore whether and how regulatory institutions and frameworks could incorporate governance aspects into their remit.

Both private and public actors will seek to shape regulation in their favour. A private provider may,

for example, offer bribes to achieve a favourable framework, and some officials may be willing to accept such a deal. In order to prevent political and administrative corruption in regulation, the water sector needs to:

1. prevent political interference
2. safeguard regulatory integrity
3. prevent fraud and political interference at utility level
4. improve overall accountability (transparency, participation, sanctions) in regulation (Boehm et al. 2011).

If prevention – e.g. through regulation – does not work and corruption comes to light, prosecution by state authorities must take place in a timely manner. Although the mandate for prosecution lies with institutions outside the water sector, water sector institutions should actively cooperate with the relevant authorities to make sure corruption is condemned.

Turning integrity challenges into opportunities

In most cases, private companies in the water and sanitation sector are able to ensure integrity regardless of the quality of the regulatory framework, because they can define their corporate values and responsibilities independently. Businesses and business-like actors (such as NGOs) that do engage in corruption and other forms of dishonest behaviour do not see such actions as ends in themselves. The main driver of doing business is to earn money and make a profit, and unethical behaviour is aimed at giving businesses on the supply side of corruption a competitive advantage over their rivals. However, by integrating water integrity principles and measures into their dealings, private companies actually stand to benefit.

It is therefore important to clarify the advantages of promoting integrity within a company specifically in terms of how this can contribute to its competitive advantage in the marketplace. The main business advantages of behaving with integrity in the water and sanitation sector include:

- A Unique Selling Proposition (USP) – With a clear commitment to integrity, it is possible for early movers in a market to create a USP that can help them win projects in the water and sanitation sector. For some customers at least – public authorities, international donor agencies, regulatory bodies – integrity is a deciding factor when awarding contracts.

- Lower costs, higher margins – Systematically avoiding transactions where bribery is an issue can substantially reduce costs and increase margins for many companies. Beyond the savings for individual companies are wider opportunities for profit, as corruption damages the entire market by reducing competition and levels of investment in infrastructure, eventually undermining growth (WIN & TI, 2008).
- Lower risk of prosecution – A high level of integrity greatly reduces the risk of being charged or prosecuted for illegal transactions and economic crimes, which results in fewer fines, lower legal costs and lower opportunity costs for the time invested in legal proceedings.
- Reduced reputational risks – Growing awareness among civil society and its representatives (community organisations, consumer associations, NGOs, etc.) of non-compliance with integrity principles, and their ability to communicate this, means corrupt behaviour is increasingly likely to be exposed, endangering the operations and public image of a private company. Corporate integrity can reduce such reputational risks.

There is now wide acceptance that companies have to take internal steps to promote integrity. They need a zero-tolerance policy towards bribery and corruption, which must be enforced through specific anti-corruption measures. It is also generally recognised that collective action builds trust and can enable companies to better resist extortion or demand transparent procedures from public authorities. In Uganda, the Association of Private Water Operators (APWO) shows that private actors in the water sector can take meaningful steps in this direction. In its Code of Business Ethics and Conduct, APWO defines values and principles with which its members must comply (APWO, 2012). Similarly, in its code of ethics, the International Federation of Private Water Operators (AquaFed) encourages its members to ban any kind of corrupt trading practices (AquaFed 2005).

Beyond these two examples, several organisations have established principles, codes of conduct and recommendations to counter corruption in the private sector (see Business Principles for Countering Bribery and the WIN Code of Conduct in Box 3). However, operational tools need to be made available and adapted to specific water sector conditions in different countries. Companies in the sector should

BOX 3 Tools to enhance integrity in private sector engagement

Integrity Pacts are a tool used in public contracting processes to increase transparency and accountability and restrain corruption, so enabling projects to be completed successfully. The pacts involve a contract committing all actors in a bidding process to behaving with integrity. To ensure accountability, they also include a monitoring system, typically led by civil society groups. The integrity pact concept has been adapted and applied in a wide range of water projects (WIN & TI, 2010).

The WIN Code of Conduct defines values and guiding principles through which both private and public actors can express their commitment to high standards of transparency, integrity, participation and accountability in the water sector. Signatories of the code commit to providing collective and collaborative leadership in promoting water integrity.

The Business Principles for Countering Bribery, developed by Transparency International and Social Accountability International, provide a framework for companies to develop comprehensive anti-bribery programmes. They apply both to the bribery of public officials and to private-to-private transactions. The principles are designed to provide practical anti-bribery guidelines for all enterprises, to help create a more level playing field (TI, 2009).

Integrity Management is a concept that can help introduce and systematically operationalise integrity values into business models, as well as quality and risk management systems. To address the specific characteristics of the water sector, the Integrity Management concept should be adapted, building on available tools and approaches used by private actors in the water sector to avoid corruption (WIN, 2012a).

take a step further and integrate integrity issues into business models and quality and risk management approaches. This can help to bring into practice transparent, ethical approaches that are compliant with laws and regulations and will promote better performance by individual companies and the sector overall. The reform processes of Severn Trent (see Box 2) and Sydney Water (see Box 4) demonstrate a comprehensive approach to preventing corruption that others can build on.

CONCLUSION

In order to develop infrastructure and to build knowledge and capacities, the water sector needs private sector engagement. Private operators are also directly involved in operational tasks in water supply and wastewater management. Water is a precious commodity, and corrupt practices by private actors will draw particular attention from the public. Businesses engaging in the water sector with clear strategies to enhance integrity in their operations can generate a competitive advantage and reduce reputational, legal and financial risks.

Discussion about integrity issues surrounding private sector engagement in the water sector must go beyond the corrupt behaviour of the private actors themselves, and acknowledge that corruption is most likely to occur

at the interface between private actors and public officials. Transparent, clear and reliable regulation and effective mechanisms for redress are therefore needed. Companies themselves also suffer when competitors pay bribes to win contracts. The water sector should therefore find ways through which companies affected by corruption can be mobilised to report on bribery and collusion.

Commitment is needed from high-level individuals in both the private and public sectors to condemn corruption and make integrity a priority for corporate governance. A proactive approach which communicates the comparative advantages of integrity for business is needed to motivate companies to implement anti-corruption measures and take a lead role in promoting integrity.

BOX 4 Investigation of Sydney Water Corporation employees, contractors and third parties

After receiving a complaint in 2009 about an employee soliciting bribes, Sydney Water, a state-owned utility, reported the matter to Australia's Independent Commission Against Corruption (ICAC). During the following month, several further allegations of corruption were made. In 2010 the ICAC conducted a public inquiry into these allegations, involving employees, accredited constructors, licensed plumbers and other actors related to Sydney Water. While corruption occurred within different areas of the utility, the cases were clearly linked to its private contractors. The investigation found that nine people, both utility staff and private actors, had engaged in corrupt conduct, including:

- » soliciting and/or receiving bribes from accredited constructors;
- » giving false evidence in the compulsory examination of accredited constructors;
- » utility staff making contractual arrangements with private actors without authority to do so;
- » private actors receiving money by submitting invoices containing false information to the utility;
- » obtaining a financial advantage for a company by deliberately misleading utility staff into signing a paper to register the utility's trademark and logo with respect to bottled water.

The investigation report included specific recommendations to reduce corruption risks, such as controls, management training, technical solutions guidance and awareness raising. Many of the recommendations specifically address risks at the public-private interface, including:

- » revised procurement processes to ensure that one individual cannot request, approve and certify delivery of a purchase;
- » evaluation in internal audits of the implementation and operation of divisional anti-corruption plans;
- » integration of corruption prevention strategies in strategic business plans;
- » management training in overseeing subordinates' interactions with external parties (e.g. detecting and acting on warning signs);
- » development of a dedicated complaints management system;
- » extension to the public of access to the organisation's Corruption Hotline via its website homepage;
- » establishment of an automated process to check invoices for order splitting;
- » automatic comparison of vendor details on invoices with the company's database;
- » development of a list of manual checks that accounts staff should perform on invoices;
- » procedures to ensure accounts staff are fully aware of fraud risks..

Sydney Water's 2011 annual plan committed the utility to implementing all recommendations by the end of 2011, most of which it achieved.

Source: ICAC 2011

For a detailed list of references that this paper is based on, please contact us or refer to our website.