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**Public Sector Reform in Australia: An Evaluation of the  
Corporatisation of Sydney Water, 1995 to 2002**

by

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# **Public Sector Reform in Australia: An Evaluation of the Corporatisation of Sydney Water, 1995 to 2002**

**Andrew Jane and Brian Dollery\*\***

## **Abstract**

The corporatisation of Sydney Water from 1995 onwards formed part of a much broader process of public sector reform in Australia. However, Sydney Water represents an unusual case study of corporatisation since it has embodied two distinct forms of corporate structure over the period 1995 to 2002; both the company model and the statutory model. This paper seeks to evaluate the success or otherwise of this corporatisation process using “internal” measures of performance appraisals undertaken by “outside” bodies in four main forums: The independent assessments against Operating Licence conditions, New South Wales Government’s annual assessments of government businesses performance, Sydney Water’s own performance measurement against corporate Business Plans, and water reform measures stipulated by the Council of Australian Governments.

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On the last day of the 50<sup>th</sup> sitting of the New South Wales Parliament in 1994, the Hon Robert Webster MLC (Minister for Planning, Minister for Housing) read the Water Board Corporatisation Bill for a second time. The Second Reading of the Bill represented a significant milestone in the management of Sydney's water supply; the final step in a series of tortuous negotiations that would see the historic legislation pass through the Upper House by only one vote; the casting vote of the Legislative Council President. Sydney Water Corporation Limited accordingly commenced operations on 1 January 1995.

Sydney Water is presently a statutory state-owned corporation wholly owned by the people of NSW. It runs according to an Operating Licence issued by the NSW Governor and is accountable to a Minister of the NSW government. Its current corporatisation model represents the "middle ground" between a full government department and a privately owned company. It came to this position following a series of major reforms to structural operating environments that occurred from the late 1980s, dominated by corporatisation in 1995.

Corporatisation represents the application of specific commercially-oriented management techniques to improve the efficacy of government business enterprises, such as Sydney Water (Fisher, 1998). It is a technique that has been used widely in the utilities industries, both domestically and internationally. In NSW, two models of corporatisation have been employed.

In the first place, the *company model* instituted management practices based on the private sector, while still maintaining the majority shareholding in public hands. Second, the *statutory model* has been used to obtain commercial objectives while maintaining close ministerial scrutiny over the operations of particular organisations. Sydney Water has been subjected to both models.

Considerable time has passed since the Sydney Water Corporation Limited began operating as a corporatised entity and it is thus now feasible to take stock of the success or otherwise of this exercise. In this paper we seek to evaluate the performance of Sydney Water in terms of the performance appraisals conducted by the various regulatory agencies charged with oversight of Sydney Water. We do not develop alternative measures of Sydney Water's performance since our primary interest resides in the process of corporatisation *per se* and its evaluation in its own terms.

The paper itself is divided into five main parts. The first section of the paper outlines the nature of the corporatisation legislation and the management structure put into place to facilitate operational and commercial objectives. Section two briefly analyses the two main corporate structures Sydney Water has employed since corporatisation. We then discuss the legislative change in Sydney water's operating environment from a company state-owned corporation to a statutory state-owned corporation. Part four examines the performance appraisals undertaken by "outside" bodies in four main forums: The independent assessments against Operating Licence conditions, NSW

Government's annual assessments of government businesses performance, Sydney Water's own performance measurement against corporate Business Plans, and water reform measures stipulated by the Council of Australian Governments. The paper ends with some brief concluding remarks on the overall performance of Sydney Water since corporatisation.

## **1. LEGISLATIVE ACCOUNTABILITIES**

Following from the Sydney Water Corporatisation Act 1994, three working documents became the major tools by which the organisation would operate as a corporation: the Operating Licence, the Statement of Corporate Intent, and the Customer Contract. The main elements of the Sydney Water Corporatisation Act and the three mechanisms to achieve these objectives are briefly summarised below:

### ***1.1. Operating Licence***

Sydney Water has held two Operating Licences since it was corporatised. The first was established with the company model in mind and applied to the five-year period 1 January 1995 to 31 December 1999 and was granted by the NSW Governor under Section 12 of the Sydney Water Corporatisation Act 1994. The Licence covered four main operation areas: Provision of Systems; Customer Supply; Quality and Performance of Services; and Pricing. Provision of Systems refers to the supply of water, sewerage and stormwater drainage systems. Customer Supply refers to the availability of services and other supply

services, the conduct of customer councils, and customer complaints. Quality and Performance of Services specifies minimum standards and compliance of services, particularly water and sewerage system standards. Pricing specifies the charging regime of Sydney Water for its services (Sydney Water, 1995).

The second Operating Licence applied to the period 1 January 2000 to 31 December 2004 and was designed to meet the change in governance focus that came with the Water Legislation Amendment Act 1998. The Licence was renewed under Section 17 and amended under Section 16 of the Sydney Water Act 1994. The focus of this Licence is somewhat more prescriptive in nature, reflecting the higher degree of government involvement in the minimum performance standards of the organisation. In addition to the four major themes contained within the first Licence, the second Licence highlighted three areas that were aggregated and reported under the previous Licence under the heading “Other Performance Requirements”. They are now requirements in their own right. The three highlighted areas are: Water Quality; Water Conservation and Demand Management; and the Environment – Indicators and Plans. Water Quality specifies minimum standards, monitoring and reporting. Water quality must meet the National Health and Medical Research Council (NHMRC) and Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) 1996 guideline standards while monitoring and reporting requires Sydney Water to produce an Annual Drinking Water

Quality Monitoring Program and accompanying report to be made available to the public on Sydney Water's internet site (Sydney Water, 2000).

Water Conservation and Demand Management, among other requirements, specifies per capita consumption reduction targets: For example, "364 litres per capita per day by 2004/2005 and 329 litres per capita per day by 2010/2011" (Sydney Water 2000, p. 20). The Demand Management Strategy would be enforced using demand-side management as the basis for planning services and per capita consumption reductions. Minimising discharges to receiving water bodies, such as oceans and inland river systems, is also a key objective of the Water Conservation and Demand Management requirements.

Finally, Environment: Indicators and Plans specifies Sydney Water's responsibilities against various environmental indicators, notably Ecologically Sustainable Development and Sydney Water's Environment Plan and Energy Management Policy.

## ***1.2. Customer Contract***

Under its Operating Licenses, Sydney Water has held two contracts with its customers, known as "the Customer Contract", since corporatisation. The first, established on 1 January 1995, covered the two broad themes of Customer Rights and Sydney Water's Rights. Customer Rights stipulated minimum service standards to which the customer was entitled, including water and wastewater services, maintenance and repairs, notification of interruptions to service, and billing. Sydney Water's Rights stipulated the right to interrupt,

refuse and charge for specific services where it was deemed necessary (Sydney Water, 1995).

Drawing strong parallels with the second Operating Licence issued to Sydney Water in 2000, the second Customer Contract, issued on 1 April 2002, is more prescriptive in nature than its predecessor and its structure is different. Rather than relying on the Customer/Sydney Water rights themes, the new Contract is centred on the themes of billing, supply, maintenance and service redress with the responsibilities of both the customer and Sydney Water specified in detail. The 2002 Contract is not specific about its termination date as a working contract, only that it expires with individual customers when they cease to be customers of Sydney Water.

### ***1.3. Statement of Corporate Intent***

The Statement of Corporate Intent (SCI) is an annual document produced by Sydney Water, in agreement with its shareholding Ministers, specifying performance targets covering business strategies, financial performance, capital program outcomes, and asset and liability management. The SCI is a requirement of the State-Owned Corporations Act 1989 and is thus a requirement of all statutory state-owned authorities covered by the Act. The alignment of the SCI as a working document with the Operating Licence and Customer Contract is supported by Sydney Water's 2001-2002 SCI Statement (2001, p. 1): "Clear commercial and customer objectives and accountabilities

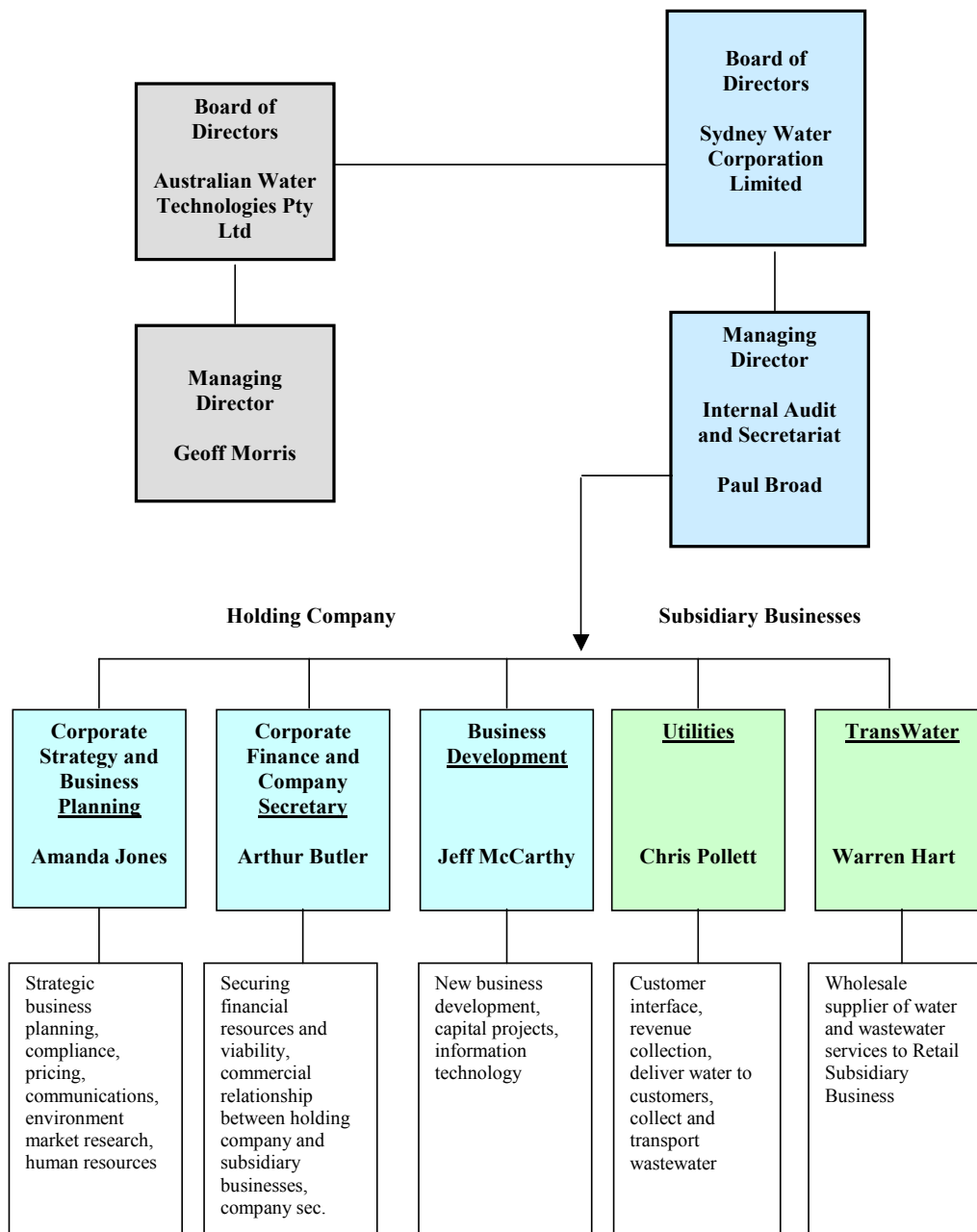


also arise from the Corporation's Operating Licence, Customer Contract and this document, Sydney Water's 2001-2002 Statement of Corporate Intent".

The most recent SCI outlined its four core objectives as follows (Sydney Water, 2001, pp. 1-2): "reducing costs to a level that assures customers are getting value; being responsive and proactive in customer service; exploiting core competencies into new business opportunities; and improving shareholder value".

## **2. CORPORATE STRUCTURE: FROM COMPANY TO STATUTORY STATE-OWNED CORPORATION**

A Holding Company/Subsidiary Business model was originally embodied in the Sydney Water operating structure and enforced prior to corporatisation as indicated in Sydney Water's 1994 Annual Report. However, while the model operated both under the old and new governance regimes, its main intention was the forthcoming corporatisation and the effective internal management of the objectives that corporatisation would bring. The Holding Company/Subsidiary Business model is illustrated in Figure 1.



**Figure 1: Management Structure Sydney Water Corporation Limited 1997**

Source: Adapted from Sydney Water Annual Report (1997, pp. 26-27)

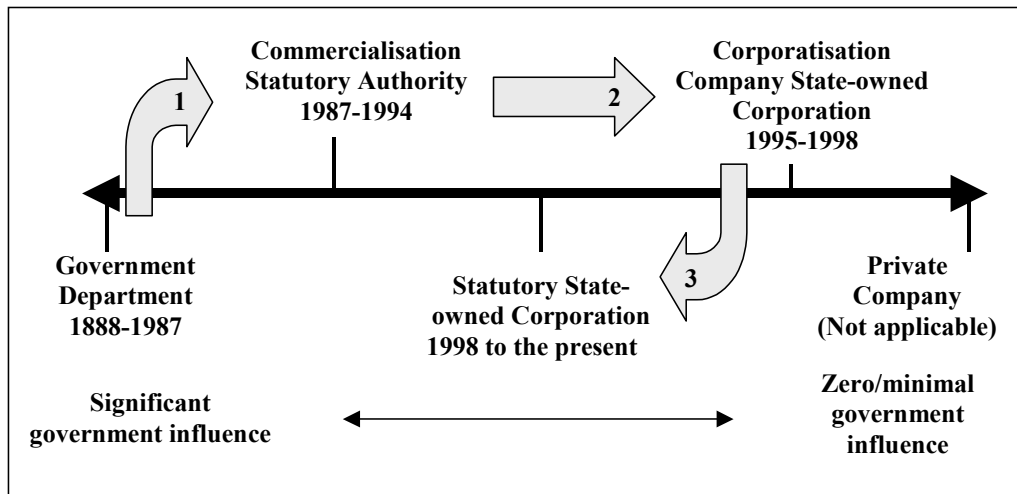
There are three main elements in Figure 1. In the first place, it is apparent that Australian Water Technologies Pty Ltd, Sydney Water's competitive trading

arm, operated as a separate company and did not form a part of the main organisational structure under Sydney Water's Managing Director. Second is the holding company/subsidiary business structure in which the retail and asset management functions (subsidiary businesses), or the "doing" come to the fore with the Holding Company functions, or the "supporting" conduct the administrative and planning functions of the organisation. Finally, when compared to the later structure that would follow, the number of divisions and corresponding general managers is relatively small.

1998 was a very difficult year for Sydney Water. It saw a series of "boil water alerts" issued to the Sydney community during July, August and September following the detection of cryptosporidium and giardia in Sydney's major water supply system. The NSW Premier, established a public inquiry into the contamination incidents. The McClellan Inquiry (1998), chaired by Peter McClellan QC, resulted in 91 recommendations to the government for the improvement of Sydney's water management systems. Two major factors arising from the Inquiry were of major operational significance to Sydney Water's operating environment. The first was the creation of the Sydney Catchment Authority, a NSW statutory authority that commenced operations on 2 July 1999. The new authority effectively took over the management of Sydney's water catchments, dams and major pipelines that had previously been the responsibility of Sydney Water.

The second major implication for Sydney Water was the removal of the company state-owned corporation model to a statutory state-owned corporation. This was enacted by the Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998. In essence, this Act removed Sydney Water from the company model, and thereby corporations law, drawing the organisation closer to government accountability. Commenting on this change, Sydney Water Chairman Gabrielle Kibble, in the Chairman's Report for the 1999 Sydney Water Annual Report, stated that (1999, p. 4): "This may appear to be a minor matter to some. However, its impact cannot be underestimated in its alignment of the Corporation to the Government of the day. Sydney Water is now more accountable to its responsible Minister and through this, the Minister is more accountable to the parliament and people for the actions of the Corporation".

With this in mind, Figure 2 seeks to place the most recent legislative operating environment in context with the other major operating environments Sydney Water has held.

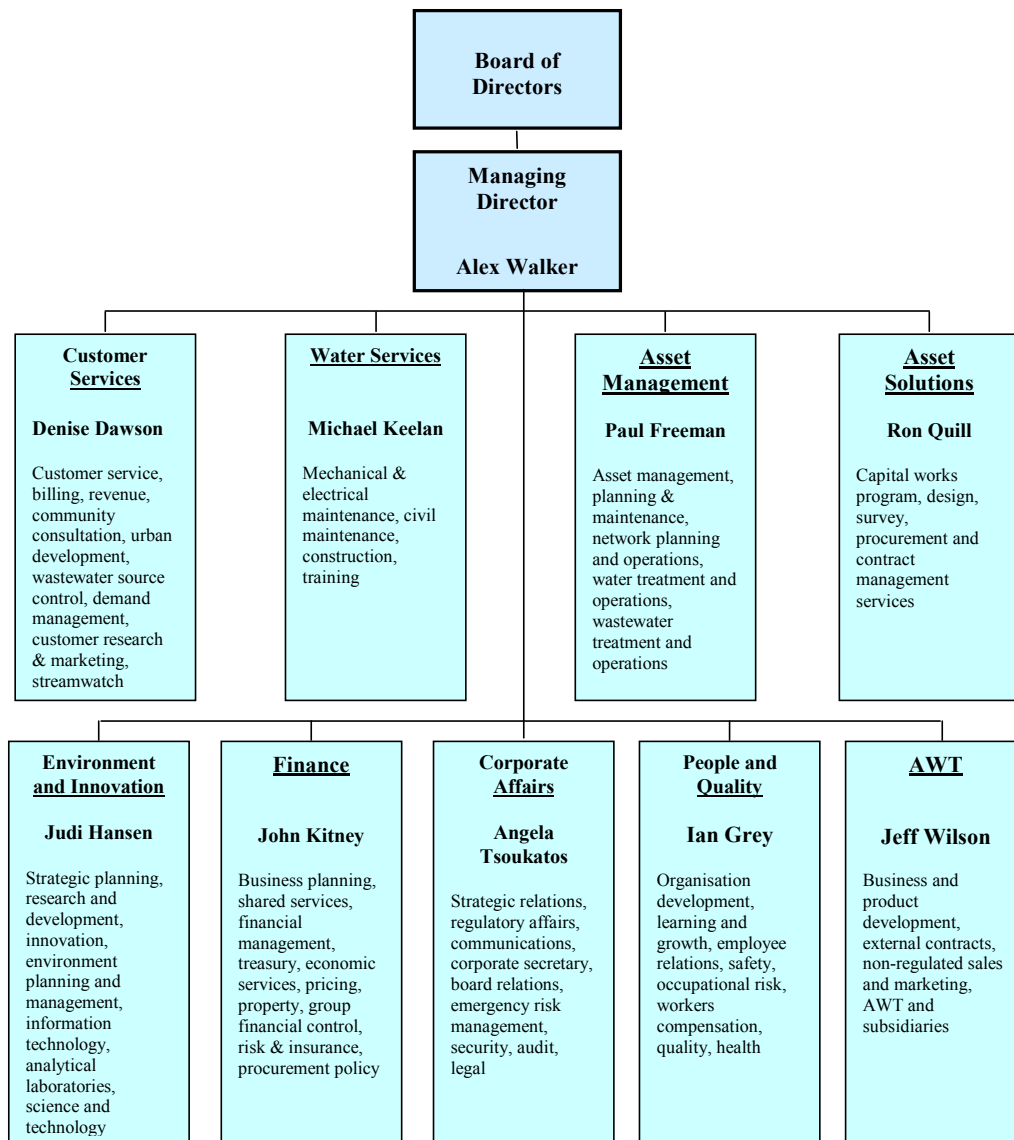


**Figure 2: Sydney Water on the Government Department/Privatisation and Government Influence Scales**

Figure 2 illustrates the movement of the operational structure of Sydney Water along a scale representing full government department on the left and privatisation on the right. In sum, there have been three major movements in the operations of Sydney Water along this scale. The first is the right hand movement from a government department on the left of the scale to a more commercialised statutory authority in 1987. The second movement is perhaps the most significant along this scale, with the full corporatisation of Sydney Water in 1995 using the company state-owned corporation model. The next step to the right of this model would be privatisation in some form, be it partial or complete privatisation. This did not occur. The third movement is to the left of the scale with the removal of Sydney Water from the company model to a statutory state-owned corporation in 1998. This position represents the middle ground on the scale with the removal of corporations law from Sydney Water's

responsibilities, thereby positioning the organisation closer to government scrutiny.

Apart from these major structural changes, the new operating environment brought with it many other changes. These included a new Chairman of the Board, a new Managing Director, and a new internal management structure to meet the new statutory operating environment. The new management structure (as at 2002) is shown in Figure 3.



**Figure 3: Management Structure Sydney Water Corporation 2002**

Source: Adapted from Sydney Water Annual Report (2002, p. 35)

This new structure was largely in place by July 2000 with the exception of Australian Water Technologies that operated as a separate company, as reflected in Figure 1, until 30 June 2001. The integration of Sydney Water and Australian Water Technologies would be a major objective of Walker's tenure as Managing Director. The management structure in Figure 3 is considerably

different to that of the Broad management structure in Figure 1. In essence, there are two major differences. First, the divisions are more numerous and horizontally integrated with nine divisions and General Managers in the 2002 structure. Second is the integration of Australian Water Technologies into the one Sydney Water management structure as of 1 July 2001. Sydney Water Managing Director, Mr Alex Walker, in the Managing Director's Report for the 2002 Sydney Water Annual Report, stated that (1999, p. 8): "The aim (of integrating the two organisations) was to increase Sydney Water's productivity and quality of service by improving processes, avoiding duplication and leveraging the combined attributes, capabilities and knowledge of both organisations. One year on, Sydney Water is well on its way to delivering the improvements sought by this initiative".

### **3. PERFORMANCE MEASUREMENT**

Performance measurement for Sydney Water has occurred in four major forums in recent years, mostly since corporatisation. The first is an independent assessment of Sydney Water's compliance with Operating Licence conditions. These assessments have typically been conducted by a government appointed independent licence regulator and, more recently, by the Independent Pricing and Regulatory Tribunal (IPART). The second assessment forum appears in the NSW Government's annual *Performance of NSW Government Businesses* publication. The third is Sydney Water's own reporting against its Business



Plan objectives through its Annual Reports. These reporting lines were followed in three selected years for the Operating Licence and Business Plan assessments. These were 1996, 1999 and 2002. 1996 represents the second year of Sydney Water operating as a corporation and provided a useful measure shortly after this significant change. 1999 is the year following the 1998 water quality incidents that resulted in legislative changes in Sydney Water's operational structure and environment and thus yielded a useful measure against these operational changes. 2002 is chosen simply because it is the most recent reporting period in which documentation is readily available. There is also uniformity in the gap between the years 1996 and 1999, and 1999 and 2002. The review adapted from *the Performance of NSW Government Businesses* covered the full period 1993-2002 with tabular and graphical trends.

However, there is one final and fourth measure from which to assess performance. In 1994, the Council of Australian Governments (COAG) established the Strategic Water Reform Framework with a set of requirements to be met by all Australian water agencies by 1998. The Framework was later ratified as a key component of National Competition Policy. Sydney Water's 1998 Annual Report outlined achievements against these requirements.

As we indicated at the outset, performance measurement in the present context largely restricts performance measures to published statutory documents, such as audit reviews and annual reports, and the satisfaction of alternative measures

and requirements imposed on Sydney Water, like those enforced by COAG. Each performance measure is different from the other, and exogenous variables, such as economic, political and social events, are not fully discernable in published data. The performance measures employed are therefore utilised in their aggregate, based on information available at hand, to provide an indication of the success of the tools of corporatisation, rather than a complete analysis of each tool and its respective success in achieving full efficiency.

#### *3.1.1. Operating Licence Audits –Key Findings 1996, 1999, 2002*

Sydney Water is independently audited against its Operating Licence conditions each year with a report presented to the responsible Minister for tabling in the NSW Parliament. Until 2000 (up to and including the 1999 operational audit), the audit has been the responsibility of the independent Licence Regulator appointed by the Operating Licence Minister under section 30 of the Sydney Water Act 1994. From 2001, the Independent Pricing and Regulatory Tribunal has assumed the role of Licence Regulator and therefore, the annual independent audit. The structure of the audits largely followed the structure of Sydney Water's Operating Licence. As a new Operating Licence was issued to Sydney Water in 2000, the structure of the 2002 Audit in this analysis differed somewhat from the 1996 and 1999 audits. Accordingly, the 1996 and 1999 Audits are summarised under their four common themes: environment; customer inputs and complaints; wastewater services; and water

supply. The 2002 Audit is reviewed separately with six themes: customer and consumer rights; water quality; system performance; water conservation and demand management; environment and dispute resolution.

### *3.1.2. Key Findings - 1996 and 1999 Operational Audits*

Environment: Sydney Water's Environment Plan, established in 1995, provided the mechanism for addressing environmental issues and objectives for the organisation. The Plan was still in relative infancy for the 1996 audit, with amendments to the Plan in subsequent years. The Audit found high or full compliance had been achieved in the attainment of 95 targets and 30 objectives reflecting individual clauses of the Environment Plan (Sydney Water Annual Report, 1997). These clauses included environmental flow regimes, catchment management, environmental indicators, clean waterways objectives, energy management and site-specific requirements in Botany Wetlands and Wingecarribe Swamp. However, the Audit was critical of the updated 1996 Environment Plan, indicating that it reflected a checklist rather than a strategic tool with no indication of external review or discussion. It was thus deemed non-compliant. Insufficient progress on unsewered (backlog) areas was also noted.

The 1999 Audit produced similar findings. Until this time, Sydney Water had employed a number of mechanisms to work cooperatively with the Environment Plan, such as the incorporation of Ecologically Sustainable Development (ESD) principles into planning, an Environment Management

System and an Annual Environment Report. The Audit found high or full compliance with Environment Plan clauses with the exception of environmental flows (partial compliance) and again noted insufficient progress on the planning for the forthcoming 2000-2005 Environment Plan. Low compliance was also observed for progress on backlog sewerage services within the Clean Waterways Program.

Customer Inputs and Complaints: This category received a similar assessment to the environment in 1996 with mostly high compliance levels but distinct room for improvement in key areas, especially the operation of Customer Councils and ambiguity surrounding the definition of customer complaints. This standing improved in 1999. However, ambiguity concerning the handling of complaints continued as a theme with the Audit suggesting the forthcoming implementation of the Customer Information Billing System (CIBS) would significantly assist in addressing ongoing complaints administrative problems.

Wastewater Services: Sydney Water's responsibilities included the management of 23 sewerage systems, 7 of which drain to ocean outfalls and 16 to inland receiving waters, 31 sewerage treatment plants, approximately 650 pumping stations and 21,791 kilometres of sewers. Sydney Water received a moderate appraisal for both 1996 and 1999 with high or full compliance in most areas including sewerage system surcharges, sewage bypasses, sewerage treatment plants, pollution reduction programs and residuals management. Many wastewater services are licensed by the Environment Protection

Authority and face heavy operational and financial penalties for non-compliance in functions like dry weather overflows. Areas of concern included odour complaints from Sewerage Treatment Plants and the progress of the backlog sewerage program, and thus linked with the findings of the assessment of Sydney Water's environmental responsibilities.

Water Supply: Sydney Water provided drinking water to population of approximately 3.9 million people a 13,000 square kilometre area covering the Sydney, the Blue Mountains and Illawarra. Infrastructure included 11 water filtration plants, 14 delivery systems and 21,191 kilometres of water mains. High compliance was achieved in 1996 against health related aspects established by the National Health and Medical Research Council. The commissioning of four major water filtration plants, ensuring all Sydney Water customers were supplied with fully treated water, significantly assisted this outcome. Other areas receiving full compliance included water continuity, water pressure and reduction of water usage/unaccounted for water.

Sydney Water continued to meet water supply commitments until 1998 when various water quality incidents occurred. A number of conditions arising from the McClellan Inquiry sought to address uncovered inadequacies and these are largely represented by high compliance in most areas of the 1999 Operational Audit. However, the Audit established two areas of concern, the first of a more immediate nature, and the second long term. In the first place, the North Richmond water delivery system failed the 1996 Drinking Water Guidelines

where total coliforms exceeded prescribed standards. The Audit declared the system non-compliant. Second, it was becoming increasingly apparent that demand management objectives to conserve water were not only non-compliant, but future demand management objectives were also looking doubtful. Demand management would become a feature of the subsequent Operating Licence and the focus of future operational audits.

### *3.1.3. Key Findings – 2002 Operational Audit*

Customer and Consumer Rights (IPART 2002, p. xii): Sydney Water had achieved high compliance with most clauses of the new Customer Contract that came into effect on 1 April 2002.

Water Quality (IPART 2002, p. xii): Sydney Water obtained full compliance for the supply of treated drinking water to its customers. It also obtained full compliance for risk minimisation, and the preparation of the Drinking Water Quality Management, Monitoring and Incident Plans.

System Performance: Sydney Water obtained full compliance with system performance standards on water pressure, water supply continuity and sewage overflows. Full compliance was also achieved.

Water Conservation and Demand Management: Sydney Water had low compliance in reducing the quantity of water it draws from all sources. The Audit went as far as saying that Sydney Water would be unlikely to meet its 2004/2005 targets and for the organisation to meet its 2010/2011 targets, considerable expansion of demand management activities would be required.

Environment - Indicators and Plans: an overall partial compliance was achieved by Sydney Water, with performance varying from very high on some indicators to very low on others. The new 2000 Environment Plan included objectives for the five-year period to 2005. Sydney Water had achieved high compliance to date in the targets set within the Plan.

Dispute Resolution: Sydney Water achieved high compliance concerning external complaints handling. However, there are ongoing concerns with the internal system of the complaints registration and handling system with disparities in identifying systemic problems and an uncertain future with the demise of the promised Customer Information Billing System.

### **3.2. *NSW Government Business Performance Measurement***

The NSW Government publishes an annual account of the performance of all its government businesses in the *Performance of NSW Government Businesses*.

The performance of each government business is typically outlined against three main performance measures: efficiency; service; and finance. Although Sydney Water was corporatised in 1995, it operated as a government business prior to this and was accordingly reported in this publication for the financial years 1993-1994 through to the latest publication in 2001-2002. Table 1 details Sydney Water's outcomes against each criteria under the three main performance measures. Figures 4 through to 7 illustrate key tabular results. Figures 4 and 5 cover financial outcomes while Figures 6 and 7 deal with efficiency and service outcomes respectively.

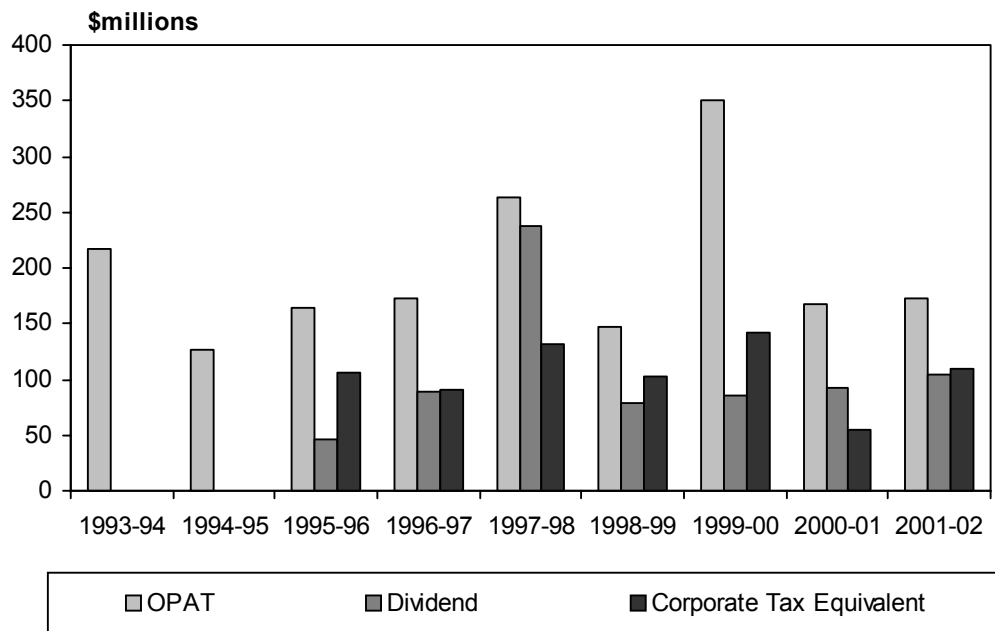
**Table 1: Sydney Water Performance Indicators: Efficiency, Service and Finances**

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
<b>Efficiency</b>									
Employment	7326	5965	5099	4763	4629	4470	3766	3676	3428
Operating cost per property (\$)	494.4	484.2	490.8	487.3	488.1	512.4	544.5	490.9	454.0
Employees per thousand Properties	5.1	4.1	3.4	3.2	3.0	2.9	2.4	2.3	2.1
Revenue collection as percentage of revenue billed (%)	99.0	99.0	98.0	98.0	98.5	98.3	98.2	98.2	97.9
Capital works expenditure: - actual/estimated (%)	68.3	65.0	84.3	68.7	89.0	101.5	100.7	101.6	108.9
Time lost to unplanned absences (%)	3.7	4.0	3.4	3.2	2.8	2.8	3.0	2.4	2.6
Injury incidence rate	6.6	5.3	4.9	4.4	3.7	3.8	3.3	2.2	2.1
Injury frequency rate	33.0	28.2	28.5	25.5	21.4	21.8	18.2	11.9	12.3
<b>Service</b>									
Million properties served	1.4	1.4	1.48	1.50	1.53	1.56	1.59	1.58	1.61
New properties served(000)	22.2	27.2	25.0	22.9	23.1	28.1	30.5	28.5	24.7
Megalitres supplied	625.0	569.0	551.0	588.0	620.0	600.0	602.0	625	622
Capital works contracted out	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
System reliability: Mainbreaks per 100 km	35.3	26.5	20.3	46.5	48.5	43.2	40.7	37.9	37.3
Sewer chokes per 100 km	75.4	87.6	69.1	80.4	112.0	80.9	62.5	70.1	67.6
Water resource management: Quality guidance compliance (1980) - health (%)	95.0	95.0	96.9	99.1	99.8	97.0	99.7	99.8	99.8
- aesthetics (%)	94.0	98.0	98.8	98.7	99.5	99.5	98.9	98.3	97.6
Waste water management: Solids removed (%)	50.0	45.0	55.0	60.0	60.0	60.0	60.0	60.0	55.0
dry tonnes of sludge per day - disposed to ocean	9.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- recycled	81.0	89.0	104.0	113.0	102.0	108.0	99.0	111.5	115.7
Pollutants discharged to Nepean/Hawkesbury system (kg/day) - nitrogen	2389.0	1726.0	1898.0	1708.0	1684.0	1689.0	1481.9	1412.0	1409.0
- phosphorus	147.0	93.0	93.0	59.0	65.0	47.0	38.1	33.0	20.4
- ammonia	506.0	151.0	137.0	50.0	57.0	76.0	56.7	48.0	46.0
Real Price Index	97.3	87.1	75.2	75.3	76.4	73.1	73.2	71.3	69.8
<b>Finances</b>									
Operating Profit after tax (\$m)	217.2	126.5	164.5	173.1	262.9	147.4	351.2	168.1	173.3
Return on total assets (%) - total	2.0	2.0	2.0	2.5	2.6	1.8	2.1	2.4	2.2
- core	2.0	2.0	2.2	2.5	2.6	1.8	2.1	2.4	2.2
Return on shareholders funds (%)	1.0	1.0	1.1	1.1	1.4	1.4	1.3	1.4	1.3
Asset Base			15378.3	15791.0	16009.5	14871.6	14281.6	13875.4	14220.4
Asset Sales	21.8	92.1	53.2	33.1	8.0	23.5	28.9	12.4	45.9
Financial Distribution - Dividend	120.7	116.5	152.5	179.1	369.2	181.4	227.2	146.8	213.6
- Corporate Tax Eqvt			46.3	88.5	238.0	78.4	85.9	91.8	103.6
Gross external debt (\$m)	2012.6	1947.6	2031.4	1989.0	1983.4	1947.7	1893.9	1923.6	2062.0



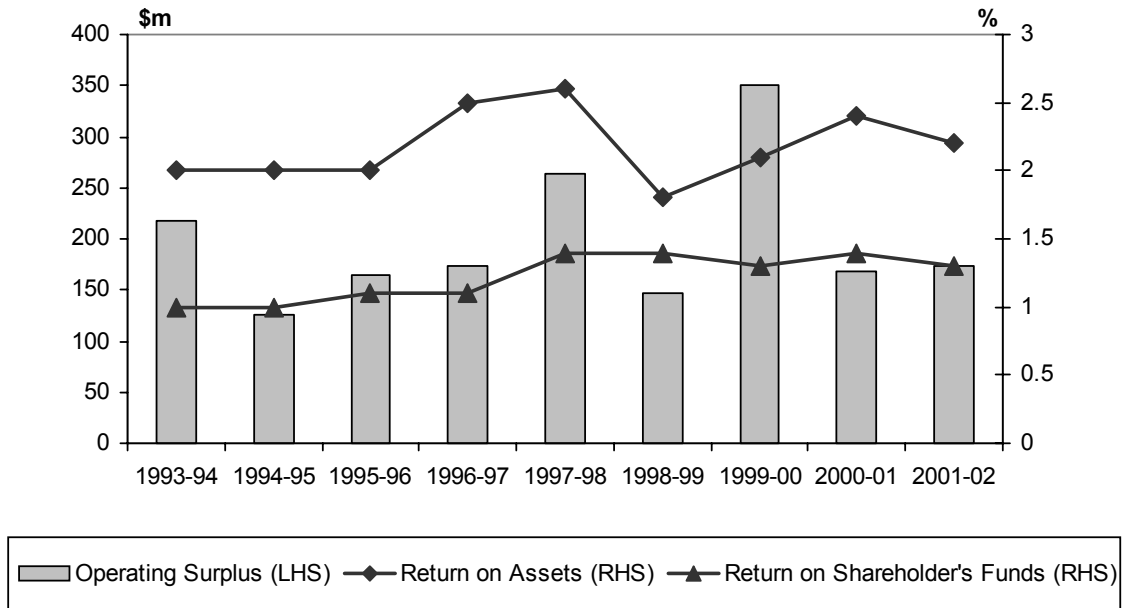
Debt/equity	20.0	16.0	16.0	16.0	16.0	16.0	18.0	18.0	19.3
Times interest earned	2.0	1.6	1.8	1.9	2.1	1.4	1.9	2.0	2.0
Community service obligations (\$m)	72.4	75.5	94.9	107.2	102.1	117.8	81.5	75.5	75.4

Source: NSW Treasury (2003: 90)



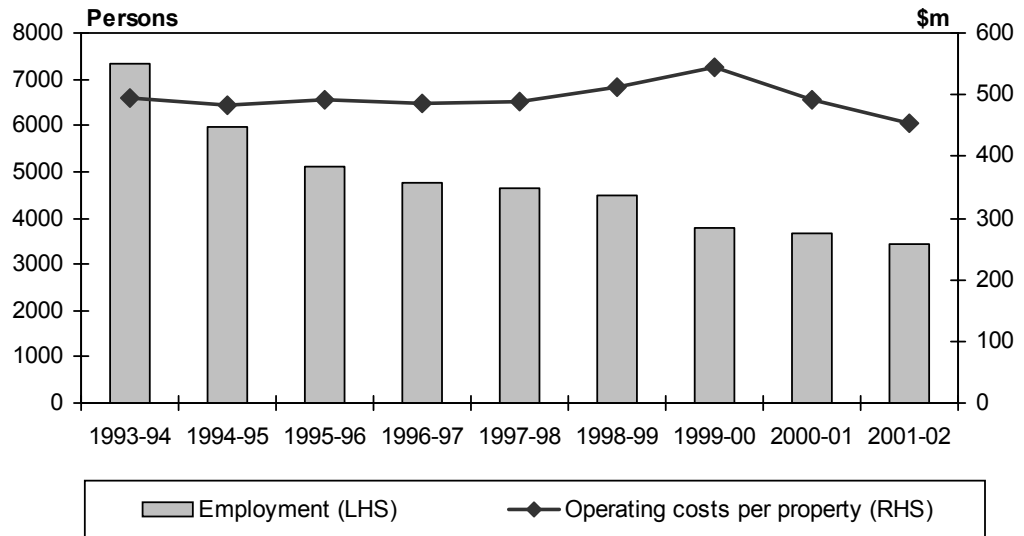
**Figure 4: OPAT and Financial Distribution (2001-02 dollars)**

Source: NSW Treasury (2003, p. 91)



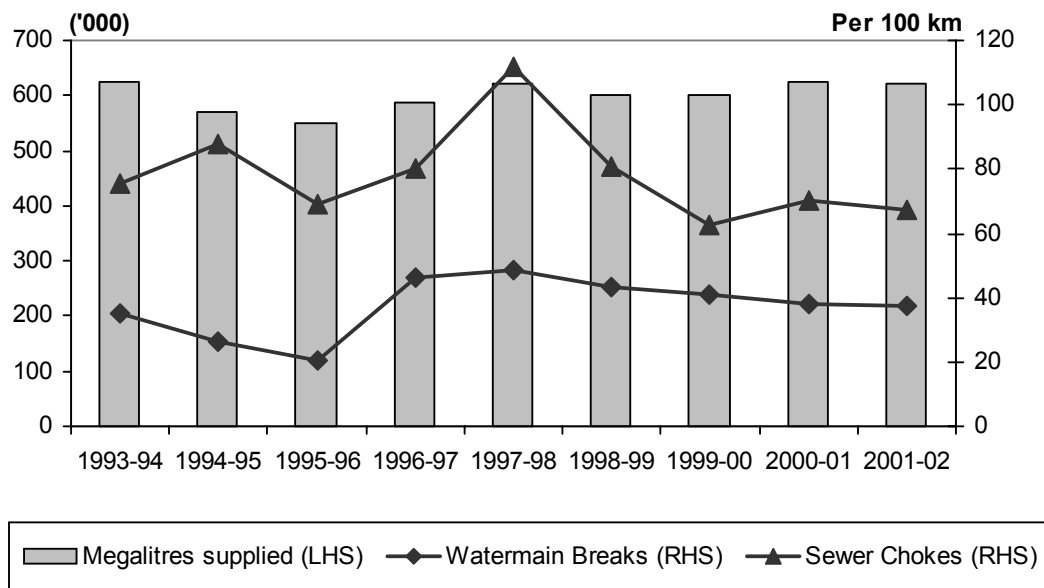
**Figure 5: Sydney Water Financial Performance**

Source: Adapted from NSW Treasury (2003, p. 91)



**Figure 6: Sydney Water Employment and Efficiency**

Source: Adapted from NSW Treasury (2003, p. 91)



**Figure 7: Sydney Water Service Performance**

Source: NSW Treasury (2003, p. 91)

It is clear that while Sydney Water has achieved respectable after tax profits each year (as illustrated in Figures 4 and 5), these profits have nonetheless varied somewhat over the period 1993 to 2002. Steady increases in operating profit after tax (OPAT) were recorded from 1994 to 1997. A satisfactory OPAT was also recorded for 1999-2000. However, there are two significant blemishes in this trend. The first is in 1998-1999 when OPAT fell from \$262.9 million to \$147.4 million. This was largely due to the financial effects of the water quality incidents of the previous year in which \$55.4 million in abnormal expenses directly linked to the crises were incurred. The remainder represented indirect expenses and losses arising from these crises (Sydney Water, 1999). The second fall is in 2000-2001 when OPAT fell from \$351.2 million to \$168.1 million. Two factors would have a significant bearing on this result.

The first was a Voluntary Exit Program in which over 800 Sydney Water and employees left the organisation with a total of \$80.3 million in redundancy payments. The second was “abnormal adjustments” of \$132.8 million to superannuation. The return on assets in Figure 5 yields a relatively inconsistent trend, mostly reflecting operating profits. However, the return on shareholder’s funds has been more consistent, showing indications of levelling out in recent years following good returns from 1993 to 1998.

The number of people directly employed by Sydney Water (illustrated in Figure 6) has nearly halved for the period 1993 to 2002. However, these reductions have not been positively reflected in operating costs per property (also illustrated in Figure 6). In fact, up to the year 2000, it appears that operating costs per property have gradually increased. This was recognised as a fundamental problem by senior management when it was established that Sydney Water operating costs were some 23 per cent above industry standards. The target of reducing operating costs per property was met in 2001-2002 through ‘redesigned business processes better procurement practices, rationalisation of corporate, and internal support services and lower labour costs as a result of the Voluntary Exit Program (Sydney Water 2002, p. 9).

Sydney Water’s service performance is somewhat inconsistent. There seems to be no particular pattern to the incidence of “sewer chokes” in Figure 7, although they are directly correlated with high rainfall. The 1997-1998 period had above average rainfall and goes part of the way to explaining the

peak in chokes during this year. The trend in recent years is of a declining incidence of sewer chokes. “Watermain breaks” are more consistent across the years with a general downward trend from 1997-1998.

### **3.3. Sydney Water Business Plans**

Sydney Water reports on its performance against corporate Business Plan objectives each year in its Annual Report. While Sydney Water reports the results, the Annual Report is subject to audit and the financial results in particular are audited and verified as being accurate by the NSW Auditor General. Two main Business Plans have been in place since corporatisation: the 1995 to 2000, and 2000 to 2005 Plans. The Key Performance Indicators (KPI) from these Business Plans for the financial years 1995-96, 1998-99 and 2001-02 are presented in Table 2, Table 3 and Table 4 respectively. Thus, Tables 2 and Table 3 represent outcomes in the first 1995-2000 Business Plan and Table 4 represents outcomes in the second 2000-2005 Business Plan.

**Table 2: Sydney Water Key Performance Indicators 1995-96**

	<b>Objectives</b>	<b>Target</b>	<b>Position as at 1995-96</b>
<b>Customers</b>	85% of customers to judge performance to be 8 or more out of 10  Meet or exceed Operating Licence and Customer Contract requirements for standards of service	By year 2001  Annual	Overall satisfaction score of 72 out of 100  First independent audit found core business objectives and environmental performance sound. Significantly improved customer complaint management but room for improvement
<b>Shareholders</b>	Meet agreed shareholder targets specified in Statement of Corporate Intent  Extend usage charges so that customers pay for water used	Annual  \$80m reduction in non-residential property taxes by 2000	Exceeded in 1995-96  IPART pricing determination for four years from 1996-97 includes elimination of further \$20m. By 2000, \$357m (85%) property taxes paid in 1992-93 will be eliminated. Usage charges currently 36% of total income

	Reduce underlying costs per property	45% from 1992-93 to 2000-2001 in real terms	9% decline in 1995-96 – a 22% reduction since 1992-93 in real terms
Staff	Provide a safe and equitable work environment. Develop a work force that can deliver business outcomes	Continuous	Sydney Water's percentage of time lost due to unplanned absences was 3.4%, below the industry average of 3.77%
	Improvement in employee satisfaction	Continuous	Sydney Water fully covered by enterprise agreements. Employee opinion surveys conducted within business units, creating benchmarks from which to measure continuous improvements
	A work and family ethos and a business which grows through its people	Continuous	Received silver award in Australian Financial review's work and family Awards
Regulators	Successful performance in Operating Licence Audits in order to retain operating Licence to deliver services to the community	Annual	Achieved
	Meet objectives and targets in the Environment Plan	Annual	Operational audit found that SWC had a high compliance with environmental targets outlined in Environment Plan

Source: Adapted from Sydney Water Annual Report (1996, pp. 8-9)

**Table 3: Sydney Water Key Performance Indicators 1998-99**

	Objectives	Target	Position as at 1998-99	Trends
Customers	To put customers first	Customer performance score 85/100 by 2001	64/100	Satisfaction fell due to 1998 water quality incidents but gradually improving
	To consistently provide quality products and services	Customer contract requirements met or exceeded	High compliance	Customer Service performance improving, trend expected to continue
Shareholders	Provide commercial rate of return to meet shareholder's expectations	Expectations specified in Statement of Corporate Intent	Financial performance in line with shareholder SCI targets	Satisfactory performance but need for future performance to meet increased standards
		Commercial rate of return on all new investments	Dividend of \$91.7m	
		Operating licence renewed in 2000	Successful compliance in 1995, 96, 97 and 98 operational audits	
	Add value to the business	Diversification of revenue stream	\$63.7 million sales sourced from non-core business (5.3 % of total sales)	Forecast sales of \$86m by 1999-2000 (6.9% of total sales)
		Economic value added to the business trend to improve	Economic value targets exceeded	Economic value added adopted for decision making throughout the organisation
		Property tax to be eliminated by 2002	A further \$40m reduction in 1998-99	\$357m eliminated to June 1999
To lead in a	Operating costs/property	Target set		

	competitive market	reduced by 23% real from 1998-99 to 2001-02  Operating and commercial agreements between holding company and subsidiaries in place  10% of AWT market generated through external sales by 2001	Commercial agreements signed  AWT generated 16.3% of total sales from the external market	Operating cost reductions a focus of all business units  Improving financial performance by core businesses  Projects underway in NZ, Fiji, Hong Kong etc
Staff	Provide a safe and equitable work environment	Unplanned absences less than 2.5% of work hours  No serious injuries	2.83% (2.79 in 1997-98)  Lost time injury frequency rate 21.80 (21.40 in 1997-98)	Slightly higher but five year trend shows improvement  Five-year trend reduction.
Regulators	Deliver products and services in a manner consistent with current legislation, regulation and guidelines  Influence regulators to achieve an informed outcome based on regulatory environment	Successful performance in operating licence audits  EPA regulations, licences and Pollution Reduction Programs to be met  Demonstrated performance against Memoranda of Understanding (MOU)  Investment decisions based on best environmental outcome and least cost planning	Achieved. Performed soundly against environmental requirements and full compliance with water quality and other operational standards  Compliance with regulators' requirements achieved.  MOUs in place with NSW Health, EPA and requirements being addressed.  Achieved	Improved on previous audit. Room for improvement in customer service performance  Constant level of performance of last two years  Existing MOUs remain effective.  Diligent planning ensures capacity to meet regulatory standards

Source: Adapted from Sydney Water Annual Report (1999, pp. 6-7)

**Table 4: Sydney Water Key Performance Indicators 2001-02**

	Objectives	Target	Position as at 2001-02	Trends
Learn, grow and be a successful business	Integrate Sydney Water and Australian Water Technologies  Improve productivity	Reduce corporate overheads by 2002	Achieved	Three year 23% operating cost reduction target met due to redesigned business processes, improved procurement, rationalisation of corporate and internal support services, and lower labour costs as a result of initiatives including the voluntary exit program  SVA and cash distribution exceeded expectations delivering a strong result
		Controllable operating cost vs SCI	Achieved	
		Cost per property on par with similar organisations by 2006	On schedule	
		Cash distribution vs SCI	\$213.4 million	
		Shareholder Value Added (SVA) vs SVA budget	\$54.4 million	
Capital expenditure	\$556.2 million			
Improve customer services	Better understand customers' and community needs and expectations  Build strong stakeholder relationships	Increase customer satisfaction with water and wastewater products and services by 2003	Water: 81% Wastewater: 82%	Steady  Significant improvement on previous year
		Create and sustain high trust	6.9 out of 10	Up from 6.7 and back to similar levels pre water crisis
		EPA	6.8 out of 10	Assisted by development of stakeholder

		NSW Health	8.2 out of 10	relationship plans
Innovation	Provide innovative products and services	Increase revenue from new markets and products	Framework approved April 2002	New contracts awarded in Thailand, Toowoomba, Hunter water and Sydney Catchment Authority
Deliver reliable quality products and services	Manage delivery water services	Review WaterPlan 21	Achieved	Sustainability of services reviewed and ways to improve sustainability and how to provide integrated water, sewerage and stormwater services
	Upgrade water services	Meet NHMRC water quality rating by 2006	99.3%	“Best in the country”
		Watermain breaks and leaks per 100 km by 2006	37	customer service to be improved through continued reduction of main breaks and leaks
	Reduce leakage of wastewater into environment	Meet Sewfix annual program		Watermain renewals: \$53.8m Relining/maintenance: \$38.5m
	Protect infrastructure	Reduce pumping station overflows in dry weather by 2006	41	
		Reduce sewer chokes by 2006	68	
	Protect assets and improve operations	Backlog number of properties services by 2006		7100 properties to be sewered by 2006
	Reduce water demand to delay need for new assets	Asset plans developed by 2006 Planned maintenance completed	Achieved 97%	In line with NSW Government Total Asset Management Manual
		Reduce average daily per capita consumption (litres/person/day) l/cd by 2006	412 l/cd	Every Drop Counts program and recycled water
	Increase biosolids recycling by 2006	99%	Organic material collected during wastewater treatment = biosolids	

Source: Adapted from Sydney Water Annual Report (2002, pp. 16-17)

Under the central themes of the 1995-2000 Business Plan (outcomes from Tables 2 and 3), customer satisfaction with Sydney Water’s overall performance was targeted to achieve a score of 85 out of 100 by the year 2001. However, this objective was somewhat damaged by the 1998 water quality incidents, falling to 64 out of 100 for 1998-99 in Figure 3. It is Sydney Water’s view that while this score is recovering, it will take time to regain the community’s trust. There appears to be satisfactory performance on customer



contract requirements but Sydney Water acknowledges that there is room for improvement in customer complaints handling as previously indicated by the Operating Licence Audits.

Shareholder performance appears to be satisfactory with adequate commercial rates of return and dividends matching or exceeding SCI targets. Good progress had been made on the elimination of property taxes (to full user-pays pricing) and the target for reducing operating costs by 23 per cent had been set. Indicators for staff satisfaction, unplanned absences and workplace safety were satisfactory. Performance on regulator requirements also appear satisfactory with adequate performance in Operating Licence Audits and the establishment of Memoranda of Understanding with NSW Health and the Environment Protection Authority.

The 2002 Sydney Water Annual Report presented its progress against the 2000 to 2005 Business Plan. The “Balanced Scorecard” performance measurement method was also implemented into Sydney Water’s internal reporting mechanisms to feed through to the Corporate Business Plan. Two key achievements are outlined by Sydney Water: the integration of Australian Water Technologies into Sydney Water’s management structure; and the attainment of the 23 per cent reduction in operating costs per property to industry standards.

Customer satisfaction with water and sewerage services is at commendable levels with 81 per cent satisfaction with water and 82 per cent satisfaction with

sewerage products and services. Satisfaction with sewerage services in particular showed significant improvements in recent years. Stakeholder Relationship Plans are also making improving the relationships between Sydney Water and its key stakeholder organisations.

Innovation and the reliability of quality products and services appear to be performing satisfactorily with international contracts indicating Sydney Water's international competitiveness. Service standards in infrastructure, such as sewer chokes and pumping station dry weather flows, appear to have ambiguous targets. However, Sydney Water's newly established Asset Plans are in line with the NSW Government's Total Asset Management Manual and thus outcomes on infrastructure should improve in the future. Water conservation and demand management measures, like the "Every Drop Counts" program are in place to achieve per capita consumption reductions by 2006. However, as we have seen, the 2002 Operating Licence Audit showed that this reduction is unlikely to occur without considerable financial and resource boost to the program.

#### ***3.4. Strategic Water Reform Framework - COAG***

The final performance measure in this paper is the Strategic Water Reform Framework, an initiative of COAG in 1994 and ratified in 1998 as the leading water industry reform requirement for National Competition Policy. Unlike the previous analyses presented in this Chapter, the Framework's requirements of Sydney Water link directly back to the national reform agenda. Sydney Water

reported against these reforms in 1998 in five themes. These are (Sydney Water, 1998, pp. 13-15): integrated management of the environment; public consultation and education; water pricing reform; institutional reform; and performance monitoring and industry best practice. COAG's requirements within each theme are individually stated. These are then supported by a summary of Sydney Water's responses to each of these requirements.

#### *3.4.1. Integrated Management of the Environment*

COAG requirement - Robust, independent and publicly scrutinised environmental impact assessments must be undertaken before new investments and significant initiatives are approved.

Sydney Water response (1998, p. 14) – Sydney Water indicated that Environmental Impact Statements or review of Environmental Factors are conducted for all capital projects, incorporating consultation with local and state government agencies, and relevant community and stakeholder groups. Sydney Water has also implemented a demand management strategy.

COAG requirement - Water agencies are to adopt an integrated approach to natural resource management.

Sydney Water response (1998, p. 14) – Sydney Water cited *WaterPlan 21*, a long-term plan for sustainable wastewater management across the Sydney region. Plans of Management for special areas in water storage catchments and environmental flows are also provided.

#### 3.4.2. *Public Consultation and Education*

COAG requirement - Implement Public Consultation mechanisms where change or new initiatives are contemplated for water resources by service providers.

Sydney Water response (1998, p. 14) – Sydney Water stated that it conducts extensive community consultation whenever it seeks changes to any of its business operations. The consultation typically involves community and stakeholder input into environmental impact assessments, environmental impact statement exhibitions and review of environmental factors reports.

COAG requirement - Develop public education programs for school age children and the wider community.

Sydney Water response (1998, p. 14) – Sydney Water has a major school and community based education program, *Streamwatch*. The program incorporates water quality monitoring kits for local creeks and waterways as a part of the school curriculum. Sydney Water's internet site also provides information for school students and other interested parties including links to other internet sites of environmental interest.

#### 3.4.3. *Water Pricing Reform*

COAG requirement - Adoption of a pricing regime based on the principles of consumption-based pricing, full-cost recovery and the removal of cross-subsidies.

Sydney Water response (1998, p. 14) – Sydney Water’s pricing reform commenced in the late 1980s with the introduction of consumption based pricing rather than land value pricing, thus eliminating the scope of cross-subsidies. The program of reform resulted in a 90 per cent reduction in property value revenues by 1999-2000 with the remaining to be eliminated by 2002.

COAG requirement - Publicly owned water service organisations should earn a commercial rate of return that reflects or proxies market pressure faced by the commercial sector.

Sydney Water response (1998, p. 15) – Since corporatisation in 1995, Sydney Water has operated as a successful business, setting positive rates of return in its Statements of Corporate Intent. It has consistently achieved a real rate of return of approximately 2 per cent per annum on its total assets.

#### *3.4.4. Institutional Reform*

COAG requirement - Separation of water service provider functions from regulatory responsibilities associated with resource management, standard setting and regulatory enforcement to minimise conflicts of interest.

Sydney Water response (1998, p. 15) – This requirement has largely been satisfied through corporatisation. Prior to corporatisation, Sydney Water maintained its own regulatory regime. Satisfying the Sydney water Corporatisation Act 1994, Sydney Water now reports to an independent regulator, the Independent Regulatory and Pricing Tribunal. Sydney Water’s

role is separated from this function and now maintains the water and wastewater services only.

COAG requirement - Water service providers are to adopt a commercially oriented approach to organisations management including service provision, investment and procurement.

Sydney Water response (1998, p. 15) – Also directly linked with corporatisation and the organisation’s operating objectives, it operates as a successful business, maximising the State’s net investment in the Corporation.

#### *3.4.5. Performance Monitoring and Industry Best Practice*

COAG requirement - Water agencies are required to participate in rigorous independent benchmarking studies to measure and monitor targeted improvements in performance over time.

Sydney Water response (1998, p. 15) – Sydney Water was the first water utility outside the United Kingdom to participate in a benchmarking study of 28 private water companies in England and Wales. The results of the study were pleasing for Sydney Water, exceeding the UK industry standards in supply interruptions, leakage and internal sewer flooding. Other areas were identified in which Sydney Water needs to improve to meet international industry standards.

#### **4. CONCLUDING REMARKS**

Our analysis of the corporatisation of Sydney Water has yielded mixed results. On the whole, performance seems reasonable with good business profits and an adequate return on assets. However, the organisation underwent two significant changes in a relatively short period of time: the change to corporatisation in 1995 using the company model, and the move to the statutory model following the 1998 water quality incidents. That is, the company model lasted three short years. This change has had an effect on the organisational structure and it can be argued that, with the greater prescriptive nature of Sydney Water's second Operating Licence, numerous and highly specified business conditions, such as water conservation targets, expose Sydney Water's vulnerabilities. Put differently, with a more prescriptive operating environment and greater government control, it appears that Sydney Water is increasingly unable to meet numerous strict conditions. This is supported by the Operating Licence Audits, with the incidence of non-compliance, particularly concerning water conservation, more prevalent in the 2002 Audit. On the other hand, Sydney Water's compliance with state and national reform targets has been met, particularly concerning the Strategic Water Reform Framework linking with National Competition Policy.

The following important questions arise: To what extent were the principles of corporatisation realised in Sydney Water and were they affected when Sydney Water changed to the statutory model in 1998? In the first place, the clarity of

objectives as outlined in the Sydney Water Corporatisation Act 1994 have remained constant over time: to be a successful business, to protect the environment, and to protect public health. However, while the objectives are clear, they are broad. The means by which to deliver these objectives are not so clear. Second, managerial authority was deliberately scaled back with the statutory model, allowing greater oversight by the responsible Minister and accountabilities to Parliament. Third, performance monitoring has increased under the statutory model by virtue of the prescriptive nature of the second Operating Licence and subsequent Audits against Licence conditions. Fourth, rewards in Sydney Water's Annual Reports have been relatively consistent over time. The only detectable sanctions were perhaps the departure of some senior managers following the 1998 water quality incidents. Finally, competitive neutrality in input and output markets cannot be fully realised under the statutory model without accountability to corporations law. One of the specific objectives of the company model was to place Sydney Water on equal footing with private sector best management. With this now effectively removed, it questions Sydney Water's neutrality position. Furthermore, the removal of competitive neutrality suggests that the parameters of corporatisation have shifted given the 1996 NSW GTE Reform Unit's stipulation that "it is not until the fifth principle (competitive neutrality) has been satisfied that the organisation can be considered corporatised" (1996, p.



2). Thus, the current model of corporatisation appears to sit uneasily with Sydney Water.

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