PRIVATE INSTITUTIONAL JOINT VENTURES: A CHALLENGE FOR WATER MANAGEMENT

JUAN RAS

DECEMBER 1995

In the October issue of the Harvard Business Review, Louis T. Wells and Eric S. Gleason quote Raymond Vernon in an article entitled *"Is foreign infrastructure investment still risky?"* remembering what he called the obsolescing bargain. I would like to quote some excerpts of their work which I found revealing.

"The theory starts with a simple principle: most countries prefer local ownership to foreign ownership, regardless of the industry, but especially in important, visible sectors. Foreigners are acceptable only if the benefits overwhelmingly outweigh the economic and political costs.

Yet infrastructure investments do not receive a continuing influx of technology, they do not sell abroad, and capital does not continue to flow in. Moreover if the foreigner leaves, the infrastructure project will remain. As a result, the presence of the foreigner may cease to be viewed as essential for the operation of the facility.

The recent figures on expropiation indicate little reason for pessimism. The resurgence of enthusiasm on the part of both new investors and old ones suggests that investors believe in change. But the herd may be wrong. Many of the underlying factors that led to nationalization in the past have not in fact changed much.

Even though actual expropiations are uncommon, new approaches such as price regulation, restrictions on working permits for foreign managers, renegotiation of contracts, and even buyouts can tip the scales in favor of the host nation.

The authors conclude that host nations may for a number of reasons see foreign investment in infrastructure as an obsolescing bargain.

I have begun this presentation with the above article summary because it seems to be an excellent portrayal of the risks that should be considered today before making any decisions on investments abroad in our area of business. Even if today we firmly believe that nationalization or expropiation dangers are a thing of the past, we cannot forget that our projects have a strong impact on the inhabitants of a country or a city, in many cases with very limited economic resources, vulnerable to the demagogic arguments fed by price increases, resource shortage periods, or projects with very long maturation periods , situations in which the obsolescing bargain becomes powerful and presents a real threat.

So we should be able to envision solutions that while providing acceptable risk levels to all parties will easily adapt to all possible future situations, even those that today in our advanced society we have not yet confronted.

If we are not able to predict what may happen in Madrid, Washington or Paris in the near future, how can we foresee in a contract lasting 25, 30 or 50 years , what will happen in cities of underdeveloped countries, where 50% of the population does not presently have access to the water supply or sewerage we are going to provide.

Lacking a better term, I will call a Private Institutional Joint Venture a company incorporated according to private law governed by the Trade Laws of private companies, headed by professional management nominated by the private shareholder and governed according to private companies' customary practices, set up to render a public service using an infrastructure not owned by it, where equity is shared in negotiated proportions by the public owner of the infrastructure and a private professional operator of recognized expertise, with both parties present in the governing bodies of the company.

This definition is notably long, but attempts to describe the following essential conditions:

- Rendering of a public service
- Organization and bylaws according to commercial laws
- Professional management
- Shareholders who fulfill two conditions sine qua non:
  - -Public, with direct responsibility for the water supply
  - - Private, with proven expertise
- Presence of both shareholders on the Board of Directors.

The company must be the only technical body authorized to make decisions affecting the infrastructure, its use, its maintenance, its development, its design, master plans, etc. These particular decisions of a technical nature will be subordinate to policies established by the Municipal Authority.

Establishing the position of a sole speaker who knows the whole problem, who can analyze it from the point of view of a day to day operator, who forecasts consumption, production and investments to be analyzed by the political or economic authorities and modified according to their criteria or possibilities, is already an improvement of such magnitude that in itself justifies its establishment and funding, since it will prevent those Pharaonic works we have all seen awaiting destiny in life. When in the same organization the management of daily operations is combined with a vision of future needs and joint decisions are made together between public and private initiative delegates, a gigantic step is taken in the right direction, capable of meeting any kind of criticism.

The need to base a relationship on rigid legal contracts or the urgency to justify a privatization with too many things being built at once, can lead to problems far worse than those we are trying to avoid.

It certainly isn't dollars that will make inadequate infrastructures operate, nor is it dollars that will succeed in changing the attitude of entire neighborhoods who have considered it a luxury to be supplied water two days a week. Dollars will not make water flow from faucets where either nothing or strange liquids drip. All this will be achieved by men and women who work in organizations with horizontal management where their opinions are listened to and decisions can be made because power is decentralized and in the hands of professional experts who have the necessary tools at their disposal and their hands free to work, not bound by red tape.

After rapidly familiarizing themselves with the problems of a real situation which they have had time to study, these experts will be in a position to recommend the most feasible investment plans and financing alternatives.

With such expertise and organization, banks and financial institutions have the confidence necessary to lend the resources needed to carry out appropiate investments at the right time. Public representatives sitting on the Board of Directors, now having real decision powers, can decide on the economic efforts that the population can actually make and accordingly synchronize investments. What is the use of rigid investment contracts, if economic conditions change, or initial data is proved wrong, therefore possibly causing resulting rates to skyrocket beyond subscribers' economic capacity.

I have already mentioned before that in a public service company personnel is the most important asset. In a Private Institutional Joint Venture or in a concession or in any other type of contract, the foreign investor will bring in specialized management capable of revitalizing a deteriorated situation. But only in a Private Institutional Joint Venture is the Public Authority certain of the correct implementation of training programs for local employees,guaranteeing a real independence from the foreign investor at the moment of contract maturity.

In a Private Institutional Joint Venture the public partner must be an active element. It must know in depth what is happening and provide its experience and knowledge. Its participation on the Board of Directors is indispensible, as is that of the private operator.All kinds of safeguards can be established there, some will derive from the previously agreed share distribution as a reflection of the equity balance. Others will be the product of specific agreements between partners, giving greater weight to the private operator in decisions concerning the technical development of the company, its daily operation, selection of suppliers or the daily economic relationship with consumers. On the other hand, the public partner may attempt to have greater say on new investments, in environmental issues, long term planning, etc. Different quorum governing members' attendance, number of votes for each kind of decision, etc. will be established in order to balance the needs and concerns of all parties.

Problems of existing structures now in service are not solved by enormous investments, rather the contrary. When able and experienced professionals are in charge, and all parties have common goals, great improvements are achieved in a short time and with very minimal investments. Consumer confidence is recovered, privatization is applauded, and local authorities are convinced that the system works to their advantage without opposition between private and public interests, thus diminishing syndicate fears of private management.

Then.as the infrastructure may need bigger investments, such operations can be carried out, keeping in mind the two main, and often misinterpreted features of every public service: real investment needs and the service's capacity to generate cash flow when properly managed.

Host countries are apt to think they face an obsolescing bargain after the initial period is over and the project's inherent imbalances surface. In a Private Institutional Joint Venture this situation does not arise. In my opinion, a Private Institutional Joint Venture is the only way to establish feasible, useful, efficient and long lasting projects.