What lessons can we learn from IEG evaluations in the energy and water sectors?

Financial, Private Sector, and Sustainable Development Department

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Acknowledgements

The synthesis was prepared by a team consisting of Kavita Mathur and Victoria Alexeeva (co-TTLs), Hiroyuki Yokoi, and Elisabeth Goller, under the guidance of Andrew Stone. Peer reviewers were Pedro Antmann and Meike van Ginneken.

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<tr>
<th>Role</th>
<th>Name</th>
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<tr>
<td>Director-General, Independent Evaluation</td>
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Purpose, Scope and Approach

**Purpose**

This synthesis aims to provide an operationally relevant review of the findings and lessons from World Bank-supported utility reforms in the energy and water sectors, as identified in IEG evaluation products. The report summarizes IEG evidence of what worked and what did not work, and why, in WB support of public utility reforms in its client countries.

**Scope and Approach**

The synthesis draws primarily from IEG’s major evaluations, Learning Products, Project Performance Assessment Reports (PPARs), and Country Program Evaluations completed over the period of 2008-2018. For the PPAR analysis, a coding template was prepared to classify the types of reforms and the achievement of outcomes. Project Appraisal Documents (PADs) were reviewed to evaluate the critical risks to implementation assessed at appraisal.

**Limitations**

The synthesis draws from existing IEG work that was conducted without an explicit lens of the utility reform’s experience; consequently the evaluative evidence is uneven across different aspects of public utility reform.
Background and Context

What is Utility Reform?

Characteristics of Effective Utility Reform

Key Challenges

Theory of Change
What is Utility Reform?

Utility reform is a means to improve sector performance and is driven by its potential to unlock efficiency gains. Reforming public utilities is an essential part of the World Bank’s engagement in the energy and water sectors in client countries.

A public utility, as defined in this synthesis, can be a public agency, a government sub-department, or a municipality, that is engaged in the provision of energy and water services.

There are similarities between the role of public utilities in service delivery in the energy and water sectors – such as cost recovery, financial viability and operational efficiency – which enables the identification of cross-sectoral learning opportunities.

Customer service provision depends on the effectiveness of technical and commercial operations of a utility, and the legal framework and governance under which a utility operates.

Bank Strategic Engagement

In the energy sector, the Bank Group’s strategy emphasizes the importance of improving the financial, operational, and institutional environment. (‘Towards a Sustainable Energy Future for All’, World Bank Group Energy Sector Strategy, 2013)

In the water sector, the Bank Group has put institutions at the top of its agenda, highlighting the need to strengthen public utilities to improve service delivery. (‘A Water-Secure World for All’, World Bank Group Water Sector Strategy, 2015)
Effective utility reform is the foundation for improved and sustained service delivery and sector outcomes.

The steps to reform a utility should include both operational and financial aspects, covering three key business areas:

1) service supply to customers;
2) commercial activities;
3) management of corporate resources, such as planning, accounting, finance, human resources, procurement, logistics, information technology.

A well-performing utility can be characterized as one that permanently provides services to all customers in full compliance with applicable quality standards (both for supply and commercial services), and that operates efficiently across all business areas within a framework of financial sustainability.
Key Challenges: Institutional Accountability and Financial Viability

Institutional accountability and financial viability are the two main challenges faced by public utilities in delivering improved outcomes in the energy and water sectors, as identified in Bank Group strategies.

**Institutional arrangements, policies, and regulations:** sector fundamentals, such as policy and regulatory frameworks and payment discipline, determine the parameters for a utility’s performance. Creating the right accountability and incentives are essential for effective service delivery.

**Strengthening sector planning, utility management, capacity and skills are needed to improve sector outcomes.**

**Enabling private sector investment:** The sectoral fiscal, financial, and regulatory framework also define and set the context for leveraging markets and the private sector to support service delivery.

**Recovering the cost of service is at the core of sector reform.**

**Maintaining the commercial viability of utilities is vital to the provision of adequate and reliable services,** regardless of whether the service delivery agents are under public or private ownership. Commercial viability entails the ability to generate sufficient income to meet operating payments and debt commitments, and to allow for growth while also maintaining service standards.

**The operational efficiency of service providers is crucial to their financial viability.**
Theory of Change
in WB Support for Utility Reform

Inputs
- Institutional Framework & Enabling Environment
  - Reform of laws and regulations
  - Preparation/strengthening of sector strategies
  - Set-up/reform of sectoral regulatory agency
  - Tariff policy/adoptions of pricing mechanisms
  - Introducing private sector participation
  - Utility restructuring (unbundling)
  - Management contract

- Financial Viability & Technical/Commercial Operations
  - Cost recovery: improving billing and collection systems
  - Improving budgeting practices
  - Expenditure management
  - Business plan: preparing multi-year plans and targets
  - Risk management
  - Upgrading the customer database
  - Setting up management information systems
  - Improving metering
  - Capacity building and Training
  - Customer orientation
  - Investment in upgrade/rehabilitation
  - Improving procurement and contracting practices

Areas of Engagement
- Design Aspect (Political Economy Analysis, institutional/financial analysis)

Actions/Interventions
- Transparency/Accountability
- Efficiency
- Improved budget management
- Cost recovery and subsidy reduction
- Improved technical operation

Intermediate Performance Outcomes
- Operational Efficiency
- Financial Viability
- Market Orientation
- Customer Orientation
- Transparency

Outcomes
- Enhanced access to affordable, reliable, sustainable energy
- Enhanced universal and equitable access to safe and affordable drinking water

Political economy, Country characteristics, external actors, macro economic events, etc.

**Energy**
- Transmission, Distribution and Disaster Reconstruction Project, Vietnam
- Energy Sector Reform Loan, Brazil
- Poverty Reduction Support Financing, Rwanda

**Water**
- Water Rehabilitation and Management Project, Peru
- Water Supply Development Project, Vietnam
- Provincial and Peri-Urban Water, Cambodia
Energy: importance of improving accountability and regulatory performance

The World Bank has long supported client countries in developing and reforming their respective policy and institutional frameworks in response to the long-term and emerging development needs of the sector.

The World Bank has been generally successful in supporting the improvement of legal and regulatory frameworks for public utilities in the energy sector.

IEG analysis of key performance indicators (KPIs) for policy reforms involving sector planning and regulations in the electricity sector showed that almost 90 percent of projects achieved their targets (FY2000-14).*

In Vietnam, the World Bank operations helped incrementally implement tariff and market regulations, through policy reforms and technical support to the electricity sector regulator (ERAV).

In Brazil, the World Bank supported a series of regulatory reforms, including rebalancing retail tariffs to reflect service cost accurately, eliminating subsidies for large, industrial consumers; reviewing distributor tariffs to ensure they were cost-reflective; revising high-voltage transmission tariffs to reflect fully geographic cost variations, leading to more economic generation siting; and resolving financial disputes among electricity companies caused by the energy crisis.

In Rwanda, the World Bank (through DPOs), IFC (through advisory), and Public-Private Infrastructure Advisory Facility (PPIAF) helped the government develop sector regulatory structures and separate water and electricity utilities to improve governance, accountability and transparency. Institutional and policy reforms transformed the Rwanda Energy Group into a commercially operated state-owned enterprise and helped attract private finance. In 2018, 52 percent of generation capacity in Rwanda was under private ownership, one of the highest shares in Sub-Saharan Africa.

* 177 of the 186 projects reviewed included KPIs focusing on institutional framework and capacity. 174 focused on sector planning and management, 56 focused on sector regulation and agency. IEG 2015. World Bank Group support to electricity access, FY2000-2014: An independent evaluation.
Water: importance of client capacity, incentives, and transparent rules

Provider performance and incentives drive service delivery outcomes in the water sector.

Transparent rules on accessing funds for water supply improvements strengthen institutional accountability.

IEG’s water and sanitation evaluation (FY2007-16) found that World Bank support for institutional building enabled its client countries to achieve qualitative improvements in sector investments.*

In Peru, the utility Sedapal radically changed its corporate management approach and work culture, including adopting a new performance-based compensation and incentive system driven by reaching results targets. Sedapal started conducting financial performance benchmarking in the context of its credit rating, with an objective for public listing. IEG’s field-based PPAR confirmed a steady improvement in access coverage, basic service parameters, and operational and financial performance.

In Vietnam, a performance-based contracting arrangement was carried out by the Ho Chi Minh City water utility to reduce water losses. The results were impressive: leakage was reduced by approximately 50 percent with minimal network replacement.

In Cambodia, the Phnom Penh’s Water Supply Authority established leak detection teams to find and fix leaks throughout the water supply distribution system. It introduced “performance incentives” (through which the most efficient teams receive monetary rewards of up to 25 percent of a technician’s annual salary) based on comparing the ratio of leaks at the beginning of the year to the ratio at the end of the year. The utility was successful in reducing nonrevenue water over the past two decades from 70 percent to about 7 percent.

* 122 of 163 projects had capacity building components. Only half of all projects with capacity-building components had specific KPIs to assess the activities’ results. Typical KPIs are the numbers of persons and training days for utility management and staff trained in administrative, technical, and financial matters, or participants in knowledge exchange programs.
A multifaceted approach to addressing financial viability

Energy: Development Policy Operations vs Investment Project Financing

Energy Performance Results

Energy Performance: DPOs vs IPFs

Energy Performance: Programmatic DPOs vs single- and multi-tranche DPOs

Energy and Water: Financial Sustainability Results

Weakening sustainability of sector financial performance outcomes

Energy Performance: Turkey’s Energy Sector programmatic DPOs (2009-13)

Water Performance Results

Water Performance: Tariff Adjustment

World Bank Support to Financial Viability
A multifaceted approach to addressing financial viability

IEG analysis of performance indicators reveals a range of World Bank interventions geared to support financial viability in both the energy and water sectors.
Energy: Development Policy Operations vs Investment Project Financing

The World Bank mainly supports the financial viability of the energy sector through two instruments: Development Policy Operations (DPOs) and Investment Project Financing (IPFs)*

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**Development Policy Operations (DPOs)**

DPOs provide quick-disbursing direct budget financing to governments for policy and institutional reforms aimed at achieving a set of sector-specific development results.

Under DPOs, policy reform measures (prior actions) typically focus on the adoption of cost-recovery tariffs, payment collection, and the reduction of commercial losses (such as metering); cost rationalization; and government subsidy transfers. Reforms related to transparency, governance, and accountability have also become more common.

**Investment Project Financing (IPFs)**

IPFs contain financial management components, sometimes accompanied by financial covenants.

Under IPFs, the typical approach is to combine financial covenants with financial performance-enhancing measures such as cost recovery plans, payment collection improvement, tariff setting methodology and adjustment, and operational performance improvement, and physical infrastructure investments.

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* PforR is a relatively recent instrument that could not be considered in this synthesis report as there is a lack of existing IEG evaluative evidence.
Out of WB electricity sector operations approved or closed during FY2000-15, there were 49 DPOs (commitment of US$10.7 billion, with US$6 billion directly related to the electricity sector) and 41 investment projects that contained components and covenants for improving sector financial performance (accounting for US$5.2 billion out of US$42.8 billion of WB overall loan commitments in the electricity sector).

IEG rated each performance indicator based on the achievement of targets.

Source: 2016. Financial Viability of the Electricity Sector in Developing Countries: Recent Trends and Effectiveness of World Bank Interventions. World Bank Group. *IEG/OPCS harmonized methodology for project evaluations uses a 6-point criteria for project ratings ranging from Highly Satisfactory (6) to Highly Unsatisfactory (1). T&D Transmission and Distribution
Energy Performance: DPOs vs IPFs

Investment projects (IPFs) performed better than DPOs on improving the overall financial performance of utilities.

DPOs were more effective in influencing tariff adjustment than covenants of IPFs.

IPFs and dedicated sector-specific DPOs typically included similar financial targets, such as adoption of cost-recovery tariffs, payment collection improvement, and reduction of technical and commercial losses. Payment collection is much more likely to improve if new meters and Management Information Systems are introduced.

**IPFs performed better than DPOs in comprehensive financial performance improvement.** For the comprehensive financial performance of utilities, this included broader policy programs, such as a financial recovery plan, debt restructuring, privatization, and commercialization. 67 percent of IPFs were effective in supporting comprehensive financial performance, compared to 44 percent of DPOs.

The relatively long implementation periods of IPFs may allow more time for hands-on operational support and corrective measures within the process.

DPOs were more effective than IPFs in tariff adjustment. 71 percent of DPOs were effective in supporting tariff reforms, compared to 55 percent of IPFs. Tariff methodology and adjustment was the second most frequent financial target in IPFs, after comprehensive financial performance improvement.

Looking at individual covenants in IPFs, compliance ranged from 43 to 88 percent. The lowest compliance was for utility profitability-related covenants, such as operating margins and rate of return on assets or equity.

The lowest result under DPOs was in reducing government subsidies.

**DPOs by design are contingent on the government undertaking policy reform measures (prior actions).**
<table>
<thead>
<tr>
<th>Programmatic DPOs</th>
<th>Single-tranche DPO</th>
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<tr>
<td>A well-conceived programmatic series proved a highly effective approach for supporting a clearly defined, medium-term financial recovery program. This approach captures the medium-to long-term nature of most significant financial and related sector reforms. It also provides sufficient flexibility to adjust to new developments and changing circumstances.</td>
<td>Experience showed that it was unrealistic to expect a single-tranche DPO to address long-standing structural weaknesses successfully, much less place the sector on the road to financial sustainability.</td>
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<tr>
<td>A programmatic approach is especially useful when the government’s reform direction is clear; but the timing and details of implementation need to stay flexible.</td>
<td>Findings suggest that reforms covered by single-tranche DPO should be designed as complementary to other World Bank operations, whether through investment lending or technical assistance.</td>
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</table>

IEG 2016. Financial Viability of the Electricity Sector in Developing Countries: Recent Trends and Effectiveness of World Bank Interventions. World Bank Group
Key Evaluation Findings

- The programmatic DPOs helped the government to introduce cost-reflective tariffs and improve payment performance for transactions in the electricity wholesale market.

- Policy reforms helped attract substantive private capital. Imbalances in electricity supply-demand were largely avoided due to large-scale private sector investment in generation capacity that increased 81 percent over 2008-12.

- Distribution company privatization resulted in more efficient management, more physical investment in distribution assets, reductions in non-technical losses, and improved service quality.

Policy reforms supported by the World Bank led to positive sector outcomes

Factors of Success

- **Strong country ownership**, where reform initiatives were underway and World Bank engagement helped facilitate the reforms.

- **Operation design underpinned by robust analytical work and focused on the most critical aspects of sector financial performance** (such as cost-based electricity pricing and full payment collection), which resulted in financial stability in the sector. Large-scale privatization of the sector strengthened these improvements.

- **The World Bank’s comprehensive and sustained operational engagement** in the electricity sector: the DPOs were complemented through a series of concurrent investment projects.

Turkey: First Programmatic Electricity Sector Development Policy Loan and Second and Third Programmatic Environmental Sustainability and Energy Sector Development Policy Loans Programs. IEG PPAR 2015


**Water Performance Results**

Financial covenants in IPFs were the most frequent instruments for incentivizing water utilities to improve financial performance in client countries.

The DPO instrument was not used significantly to reform the water sector. IEG’s water sector evaluation found that only two DPOs were carried out by the World Bank during the 10-year period (in Morocco and Madagascar).

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The overall rates of compliance with financial covenants were low in the water sector.

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### Financial Covenant Compliance Rates in World Bank Water Projects

<table>
<thead>
<tr>
<th>Financial Covenant</th>
<th>No. of Projects with Covenants</th>
<th>Percentage of Projects fulfilling covenants</th>
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<tbody>
<tr>
<td>Tariff Adjustment or Collection</td>
<td>37</td>
<td>51</td>
</tr>
<tr>
<td>O&amp;M Cost recovery</td>
<td>33</td>
<td>33</td>
</tr>
<tr>
<td>Debt Service Coverage Ratio</td>
<td>32</td>
<td>38</td>
</tr>
<tr>
<td>Operating Margin &amp; Operating Ratio</td>
<td>13</td>
<td>54</td>
</tr>
<tr>
<td>Capital Expenditure Coverage Ratio</td>
<td>13</td>
<td>23</td>
</tr>
<tr>
<td>Liquidity Ratio</td>
<td>9</td>
<td>56</td>
</tr>
<tr>
<td>Debt to Asset or Equity Ratio</td>
<td>7</td>
<td>43</td>
</tr>
</tbody>
</table>

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Compliance ranged between 23 percent and 56 percent across financial indicators.

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Water Performance: Tariff Adjustment

Tariff adjustment was complied with in only half of investment projects.

Governments are generally politically averse to public water utilities passing the full cost of services on to consumers, and the utilities rarely charge remunerative tariffs because the beneficiaries cannot afford them.

Many water utilities are characterized by low ability to recover costs, often making them dependent on financial support from government and donors.

Service providers have little ability and often no incentives to manage their assets efficiently, which result in ever-deteriorating service quality and rising costs linked to deferred maintenance.

In the absence of transparent and predictable subsidies, service providers cannot finance asset rehabilitation and the investments necessary to meet growing consumer demand, or even recover their operation and maintenance costs.
Energy and Water: Financial Sustainability Results

Sustaining financial viability proved difficult after World Bank operations closed in both energy and water sectors.

A comparison between pools of IEG KPI data and an IEG sample of post-project evaluations (38 PPARs) suggests that financial sustainability of utilities may have deteriorated after World Bank operations’ closure.

Source: Electricity KPI: energy projects with financial viability reform KPI approved by FY2014; Water KPI: water projects with financial viability reform KPI approved during FY2007-16; PPAR: IEG’s assessment of the financial viability reform of 38 PPARs. The assessment was conducted for a pool of the projects. *KPI Key Performance Indicator. See Annex C for KPIs used in this analysis.
Weakening sustainability of sector financial performance outcomes

World Bank teams were often over-optimistic that government would follow through on reform process.

At appraisal, 58 percent of reviewed PPARs assessed political economy factors as a critical risk for the implementation of the reforms (energy projects: 56 percent; water projects: 61 percent).

Risk factors included: weak government ownership and delays in the adoption of reforms; waning government commitment to push for reforms; reversal of reforms by successive governments; and political opposition to the sectoral reforms, including to privatization.

Taking the mitigation measures into account, 62 percent of projects assessed the political risk as ‘low’ or ‘moderate’.

A lack of political economy analyses to inform politically sensitive actions tended to reduce the effectiveness of operations.

Political commitment to serious financial stabilization and cost-recovery objectives is often fragile because of the political sensitivity of measures, such as tariff adjustments towards cost-recovery levels.

The presence of reform measures in a national development strategy does not always guarantee their implementation or ownership, because operationalization of the strategy and the links to policy-making may be weak.

IEG found that reliance on a national development strategy as a guide to political feasibility may lead to the under-provision of crucial, more robust political economy analyses, which could help improve project design and mitigation measures.

Source: (i) IEG analysis of PPARs under this synthesis. (ii) IEG. 2016. The role of political economy analysis in development policy operations. Washington, D.C. : World Bank Group
Cross-cutting Lessons

Cross-cutting Lessons for Energy and Water Sector Operations:
Institutional Accountability

Cross-cutting Lessons for Energy and Water Sector Operations:
Financial Viability
Cross-cutting Lessons for Energy and Water Sector Operations:

Institutional Accountability

Institutional capacity building, private sector involvement

- Accountability of service providers and effective management correspond with better utility performance and results.

- Sustainability of reforms requires competent institutions and strong administrative capacity.

- Improving sector performance through reform or restructuring can be a first step towards attracting private sector investment.

Political economy can inform specific design elements, complementary interventions and sustained support

- In both the energy and water sectors, the evidence shows that utilities’ operations and management are closely linked to the political economy in which they operate. Political economy can inform specific design elements, including choices of programmatic instruments vs. standalone operations, or front-loading vs. back-loading of important reform actions in a programmatic series.

- The DPO-supported sector reform program’s time horizon and complementary investment projects should reasonably match the time required for effective government action.

- The World Bank’s experience shows that complementary interventions and sustained support contribute positively to favourable and enduring results.
Cross-cutting Lessons for Energy and Water Sector Operations:

Financial Viability

Operational efficiency, cost recovery

- Where operational inefficiencies result in high-cost service provision, improving utilities’ operational efficiency before embarking on cost recovery through tariff reform works better, or these should go hand-in-hand.

- Inadequate cost recovery is a key driver of financial underperformance, but poor bill collection and operational inefficiencies (including excessive network losses) also have a significant role.

- Experience shows that where there are significant gaps in revenue stream, transparent and predictable subsidies may be warranted either in a transitory or ongoing basis.

Distributional issues, political economy

- Tariff reform remains one of the central regulatory challenges, and the institutional, political, and social barriers to tariff reform are considerable. Public opposition to tariff reforms reflects a lack of confidence in public service improvements and that vulnerable groups will be protected.

- It is important to understand the social impact of these reforms. Differentiated tariffs and targeted assistance programs are among measures to mitigate negative distributional impacts. Targeted programs would depend on the government’s ability to reach vulnerable households through fiscally sustainable programs.

- To sustain improvements in the delivery of services, it is critical that the framework for reform support is informed by an understanding of political economy, and by behavioural and institutional economics.
Complementary Bank Resources

**Water**


**Energy**

Annexes

**Annex A:**
IEG Major Evaluations, Meso-and Learning Products, Working Papers

**Annex B:**
IEG Project Performance Assessment Reports

**Annex C:**
Financial Viability KPIs used in the analysis
IEG Major Evaluations, Meso-and Learning Products, Working Papers


IEG Project Performance Assessment Reports


IEG Project Performance Assessment Reports


27. IEG, 2013. Project Performance Assessment Report. Croatia-Energy Efficiency Project (Ibrd); Croatia - Energy Efficiency Project (Gef); HR-Renewable Energy Resources Project -- P071464; District Heating Project-797371


33. IEG, 2011. Project Performance Assessment Report. Lao-Provincial And Rural Infrastructure Project; LA-Laos Provincial Infrastructure Project; LA-Provincial Infrastructure Project


40. IEG, 2008. Project Performance Assessment Report India-Env Capacity Bldg TA


## Financial Viability Key Performance Indicators (KPI) Used in the Analysis

<table>
<thead>
<tr>
<th>Water</th>
<th>Energy</th>
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<tbody>
<tr>
<td>• Physical (reducing non-revenue water losses)</td>
<td>• Transmission and Distribution loss reduction</td>
</tr>
<tr>
<td>• Improving operational efficiency</td>
<td>• Tariff increase</td>
</tr>
<tr>
<td>• Demand side management</td>
<td>• Subsidies reduction</td>
</tr>
<tr>
<td>• Profitability</td>
<td>• Payment collection improvement</td>
</tr>
<tr>
<td>• Cost recovery: tariffs and subsidies</td>
<td>• Profitability</td>
</tr>
<tr>
<td>• Revenue collection</td>
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</table>

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