

# **IMPROVING PERFORMANCE - INCENTIVES FOR A PUBLIC SECTOR MONOPOLY**

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This document discusses the RIC's perspective on the need for performance-enhancing incentive mechanisms to be adopted when tailoring incentive-based regulation for the electricity, water and waste-water sectors in Trinidad and Tobago.

Consultative  
Document

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## 1.0 INTRODUCTION

The Regulated Industries Commission (RIC), under Section 6(1)(h) of Act No. 26 of 1998 (the RIC Act), is required to establish principles and methodologies for determining utility rates. In accordance with Section 48 of the Act, the RIC is also required to review those principles for determining rates and charges for services under its jurisdiction every (5) years. The RIC utilizes incentive-based price controls to determine rates and charges. This requires the use of a multi-year control period to ensure that the incentives included in such a regime are effective. There are two broad sets of incentives included in incentive-based controls. The first is focused primarily on reducing costs or process innovation and the second focuses on service quality or product innovation.

With respect to reducing costs or process innovation, the central idea behind incentive regulation is to encourage firms to “outperform” predetermined benchmarks, that is, X-factors embodied in the price cap/revenue cap regime, and to allow them to retain part or all the benefit (profit) from doing so (at least for the duration of the price control period). Consequently, the firm has a financial incentive to devote efforts to decreasing its costs. Alternatively, because the firm is not guaranteed a fixed rate of return it is also motivated to improve its performance to ensure that it does not sustain losses. In this way incentive regulation mimics some aspects of the operation of the competitive market. Regulators often employ other mechanisms that work in tandem to either enhance or complement the X-factor mechanism. One such mechanism is the efficiency carryover mechanism<sup>1</sup>, which ensures that service providers have an on-going incentive to make efficiency improvements<sup>2</sup>.

Mechanisms aimed at improving service quality or product innovation are vital because incentive regulation, while facilitating a competitive outcome in some aspects of market operations, does not fully replicate a competitive market. This has led to an increasing focus on the need to incorporate service quality incentives within the regulatory regime to ensure the appropriate level

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<sup>1</sup> An efficiency carryover mechanism is the means whereby the incentive to make efficiency gains by a service provider is enhanced by permitting it to carry over gains from one regulatory period to the next. Customers benefit through lower prices in the medium and long-term, when the efficiency gains are passed through.

<sup>2</sup> The RIC consults on this issue in the document entitled “Framework & Approach for the Price Review for the Electricity Transmission & Distribution Sector (T&TEC) 2021 -2026 Regulatory Control Period”.

of quality. Therefore, incentive regulation also includes mechanisms within the regulatory framework to maintain or improve service quality or product innovation.

A number of approaches can be used to provide incentives for service providers to meet performance obligations, including:

- specification of service standards and/or obligations to apply during a regulatory period;
- reporting performance against service standards/obligations as part of the performance monitoring and reporting regime;
- designing financial incentive mechanisms to reward and/or penalize the service provider for performance that varies from pre-determined benchmarks/standards; and
- any combination of the above.

## **1.1 Purpose of this Document**

This paper discusses the need for performance-enhancing mechanisms to be adopted in tailoring incentive-based regulation for the electricity, water and waste-water sectors in Trinidad and Tobago.

## **1.2 Structure of the Document**

Section 2 of this document discusses the RIC's approach to incentives for the utility sectors of Trinidad and Tobago. Section 3 assesses the challenges of regulating state-owned and operated utilities and the possible incentive mechanisms which may be utilized to improve performance.

### **1.3 Responding to this Document**

In keeping with the RIC's obligation to consult, stakeholders are invited to comment on this document. All persons wishing to comment are invited to submit their comments. Responses should be sent by post, fax or e-mail to:

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Regulated Industries Commission  
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Port-of-Spain, Trinidad

Postal Address: P.O. Box 1001, Port-of-Spain, Trinidad

Tel. : 1(868) 625-5384; 627-7820; 627-0821; 627-0503  
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Email : [ricconsultation@ric.org.tt](mailto:ricconsultation@ric.org.tt)  
Website : [www.ric.org.tt](http://www.ric.org.tt)

All responses will normally be published on the RIC's website unless there are good reasons why they must remain confidential. Any requests for confidentiality must be indicated.

**The deadline for submission of comments is 4:00pm on June 7, 2021.**

## **2.0 RIC’S APPROACH TO UTILIZING PERFORMANCE INCENTIVES.**

In the first Price Review for the Electricity Transmission and Distribution sector (PRE 1), the RIC adopted an incentive-based approach to regulation that involved a number of mechanisms. These incentive mechanisms encompassed both financial incentives (such as a long price path, efficiency carryover mechanism and guaranteed standards scheme) and non-financial incentives (performance monitoring and reporting). These incentive mechanisms are discussed below<sup>3</sup>.

### **2.1 Setting a Long Price Path**

For PRE 1, the RIC established a price path for a period of five years based on forecasts of key components of revenue requirement (including operating and maintenance expenditure, and capital expenditure) for the Trinidad and Tobago Electricity Commission (T&TEC). This timespan allows the service provider to retain any benefits that arise from out-performing the forecasts and equally requires the service provider to bear any losses from under-performance. One of the strengths of this approach is that it leaves operational and commercial decisions in the hands of the service provider. For this approach to work, there should be limited or no opportunity for the determination to be re-opened, as it will weaken the incentive properties of the framework.

### **2.2 Building-Block Mechanism**

The RIC used a building-block approach in determining price limits for PRE1. These price limits were based on an assessment of forward looking revenue requirements using forecasts of efficient, firm-specific cost of service. The RIC was therefore able to provide incentives to increase efficiency as the approach established the allowed revenue requirement based on a buildup of benchmarks<sup>4</sup> for various cost components.

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<sup>3</sup> The methodology for PRE 1 worked well, and is being employed for the second Price Review for the Electricity Transmission and Distribution Sector PRE2 (2021-2026).

<sup>4</sup> Consideration given to both internal performance and industry best practice.

## 2.3 Rate of Change

The RIC also used ‘rate of change’ as another technique for arriving at an efficient level of operating and maintenance costs (Opex). The rate of change is the year-to-year change in Opex for a number of factors, such as expected productivity improvements in labour and other costs. This rate was established by examining the productivity achievement in Opex for a number of years and calculating future costs reductions on the assumption that the same rate of change (i.e. productivity improvement) will continue in the future.

## 2.4 Efficiency Carryover Mechanism

Apart from utilizing the above mechanisms to provide incentives, the RIC included an efficiency carry-over mechanism to further supplement the incentives for achieving efficiencies within the PRE 1 regulatory control period. There are two broad efficiency carryover mechanisms:

- A glide-path mechanism – gains (losses) are calculated by comparing actual expenditure in the last year of the regulatory period with the benchmark for that year. Benchmarks for the next regulatory period are based on the actual expenditure for the last year of the previous regulatory period.
- A rolling carryover mechanism<sup>5</sup> – efficiency gains (losses) are carried by the service provider for a specified number of years following the year in which they occurred. The benefit is then passed to customers.

The RIC had incorporated a rolling carryover mechanism into its methodology for PRE1.

## 2.5 Financial Incentives for Service Performance

Another method of providing incentives to improve service performance is the use of financial incentives. This involves the use of financial penalties for non-compliance or the linking of actual performance to prices. The two approaches are outlined below:

- (i) Guaranteed Payments – Under this approach, the service provider is required to make guaranteed payments to customers who receive service below a certain benchmark. This

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<sup>5</sup> Rolling carryover mechanism is also referred to as a fixed-term efficiency carryover mechanism.

is one of the most common approaches used by regulators to control service standards. The standards are generally divided into guaranteed and overall standards. This approach is in use by the RIC for the electricity transmission and distribution sector<sup>6</sup>.

(ii) Performance Incentive Mechanism – Some regulators include a service standards mechanism in the price control formula, this is known as the “S-Factor”. It provides an incentive for the firm to increase service levels by collecting additional revenue where the service provider exceeds pre-determined service quality targets. Such a mechanism establishes a linkage between the price level and performance indicators, out-performance is rewarded through a higher price, while failure to achieve standards results in a lower price. Although this approach provides incentives to achieve or exceed the service targets and standards, an “S-factor” incentive regime has practical difficulties. These include specifying the exact form of the S-factor and the availability of data to support it and identifying the appropriate measures of performance indicators to be included. In this regard the RIC decided not to introduce an S-Factor mechanism for PRE1 and given that that the RIC currently has very little information regarding which service indicators would be appropriate to include in an S-factor, a similar decision will be taken for the current Price Review (PRE2).

## **2.6 Comparative Performance Reporting**

Under this approach the service provider is required to report on its performance against a specified set of indicators. It is a relatively straightforward approach and arguably a pre-requisite for other forms of incentives. The reporting and auditing of the performance of a service provider against a set of indicators is expected to encourage the service provider to improve its performance, and arguably provides a solid basis for delivering the required improvements. The RIC currently utilizes this approach for the electricity sector<sup>7</sup>.

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<sup>6</sup> The T&TEC Guaranteed Standards Scheme (QSS Scheme) continues to perform well, and QSS Annual Performance Reports are available on the RIC’s website at [www.ric.org.tt](http://www.ric.org.tt). Similar standards have been finalized for the water and wastewater sectors and these are expected to be implemented once they have been published in the Gazette, and in accordance with the RIC Act.

<sup>7</sup> The RIC has implemented a Performance Monitoring Framework for the Electricity Transmission and Distribution sectors. Annual Performance Monitoring Reports are available at [www.ric.org.tt](http://www.ric.org.tt). The RIC also intends to implement a performance monitoring scheme for the generating entities which fall under its purview. The scheme will be confined to quality of service and operational efficiency indicators.

## **2.7 Applicability of Financial Incentives to the Water and Wastewater Sectors**

Utilities that are state-owned and controlled sometimes have very different objectives to those of investor-owned utilities, therefore, it may be necessary to provide additional incentives or employ different mechanisms to ensure improved efficiency by state-owned utilities. This may entail a heavier reliance on “sticks” within the regulatory framework, that is, setting tough targets coupled with appropriate penalties, rather than “carrots”, that is, rewarding performance beyond the target level.

The existing ownership and governance arrangements for the water and wastewater sectors in Trinidad and Tobago, as well as the potential conflict between social and commercial objectives may limit the effectiveness of financial incentives for service performance. Therefore, the use of non-financial incentives may be more appropriate in these circumstances. Furthermore, the primary incentive to reduce costs that is embodied in incentive regulation is the ability to retain profit for a specified period. Consequently, it may be argued that such a regime will be most successfully applied to utility service providers that are privately owned and operated, that is, conventionally financed through a mixture of debt and equity<sup>8</sup>.

The mechanisms usually employed to further incentivize investor-owned and operated utilities, such as, the efficiency carryover mechanism mentioned above, might have limited effect on state-owned utilities. In the public sector, the regulator has to assess the lowest reasonable overall cost of delivering the performance levels that the service provider is required to meet. It cannot rely on the presence of private shareholders nor market forces (there is often very little competition in these sectors) to deliver efficiency.

**Comments are invited as to whether financial incentives such as the efficiency carryover and S-Factor mechanisms are likely to be appropriate and effective for the water and wastewater sectors.**

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<sup>8</sup> Different ownership agreements, whether privately owned or state owned, will have a defined financing structure that is based on management objectives. Effective regulatory incentives should thus give consideration to a utility’s financing structure.

### **3.0 OTHER STRATEGIES FOR REGULATING STATE-OWNED AND OPERATED UTILITIES**

Well run state-owned and operated utilities are the exception rather than the rule. Indeed, most regulators acknowledge that it is often more difficult to regulate such enterprises than their private sector counterparts. While incentive-based regulatory mechanisms place greater pressure on management to reduce costs and/or improve quality, whether an entity is publicly or privately owned, these mechanisms are generally more effective under the latter, as private owners exert increased pressure on management to achieve efficiency improvements which elevate profits. The presence of private lenders (without government guarantees) can also act as a check on utility performance, especially where loan covenanting and step-in arrangements make financial performance thresholds clear.

There appears to be consensus that the reasons for the poor performance of state-owned enterprises (SOEs), including public utility infrastructure providers, are rooted in the failure of the political directorate to maintain an arms-length relationship with these enterprises (Irwin and Yamamoto 2004<sup>9</sup>, Nellis 2006<sup>10</sup>). The Government has to consider conflicting demands for limited financial resources, which means that funding may not always be made available to SOEs. The existence of a hard budget constraint is essential to the proper delivery of service and to efficiency, however, there is little scope for maintaining a hard budget constraint and creating the right incentives, without being pulled into micro-management. This issue is explored more deeply later in this paper.

Separating policy, regulation and service delivery roles, that is, making service delivery and regulation more independent and more distant from day to day political concerns, can strengthen a utility's accountability and performance. Indeed, where government is the majority shareholder the following essential principles of good governance can be applied:

- The shareholder appoints the Board, and agrees to the terms on which the Directors and senior managers are appointed.

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<sup>9</sup> Yamamoto, Chiaki and Irwin, Timothy (2004), Some Options for Improving Governance of State-Owned Electricity Utilities. Energy and Mining Sector Board Discussion paper, Paper No. 11, World Bank

<sup>10</sup> Nellis, John (2006), Privatization in Developing Countries: A Summary Assessment. Centre for Global Development, Washington D.C. & International Analytics, Bethesda, MD.

- The shareholder agrees to the utility’s Strategic Plan with the Board.
- The Strategic Plan will be a business plan setting out how management intends to deliver objectives and metrics that would be designed to deliver on and out-perform any regulatory determinations and decisions.
- The shareholder gives the Board the operational freedom to take the necessary action needed to deliver the goals and objectives of the Strategic Plan.
- The shareholder monitors the utility’s performance to satisfy itself that the Strategic Plan is on track.
- The Board is accountable to the shareholder for delivering the agreed Strategic Plan.

The RIC, in its 2006 Final Determination for the Trinidad and Tobago Electricity Commission (T&TEC), noted the importance of good governance as a catalyst for improving the performance of T&TEC. The RIC also highlighted some aspects of corporate governance that could be put in place to benefit the electricity sector, including:

- well-defined responsibilities for the State (as shareholder), the Board and senior management, to ensure that the accountability of each party is rigorous and transparent;
- the presence of high quality, independent, commercially experienced, non-executive Board members who will bring openness and objectivity but also be able to question and advise senior management, when necessary, about the different aspects of the utility’s operations; and
- transparent and appropriate incentives and penalties for staff to ensure that the right calibre of professionals are attracted to and retained at the utility. This includes the payment of bonuses, which should be published in advance and based on independently measurable and verifiable targets.

Byatt (2007)<sup>11</sup> noted that in the United Kingdom, privatization allowed the utilities to establish an arms-length relationship with Government ministers. Ministers became key standard setters,

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<sup>11</sup> Byatt, Sir Ian, “Regulating Public Utilities – Outputs, Owners and Incentives”, Occasional Lecture 20, Centre for the Study of Regulated Industries, April 2007.

maintaining public control over the collective objectives of the companies. Finance for investment was provided through the capital markets and the new owners were subject to a variety of pressures, some from markets and some from regulators, to improve both delivery and efficiency.

The challenge for many regulators, especially those of state-owned and operated utilities, is to establish the appropriate mix of incentives and mechanisms to improve performance. Some of the incentives and mechanisms that could be used to supplement the RPI – X mechanism<sup>12</sup> of price/revenue caps when applied to such utilities are outlined below.

### **3.1 Establishment of Specific Targets**

One of the most common tools utilized by regulators to incentivise performance is the establishment of specific targets in areas where improved performance is deemed to be critical. Operational, customer service and financial targets are the most commonly used. Individual performance targets with associated penalties and bonuses (in addition to the mechanisms discussed in Section 2) will add discipline and highlight areas requiring special attention. Performance targets need to be both achievable and challenging for the service provider.

In PRE 1, special attention was paid to the establishment of specific targets in a variety of key operational areas. The RIC intends to follow a similar approach in its upcoming price review for the water and waste-water sectors. Defining appropriately and with clarity, the output measures that the WASA is required to deliver and on which performance measures it will be monitored, is critical if the objectives of the RIC for the sector are to be achieved. Key areas of concern will be the reduction of Non-Revenue Water/ Unaccounted for Water, increasing the number of metered customers, and increasing the number of areas receiving a 24/7 supply. A number of other regulators have set specific targets, and examples are provided in Box 1 and 2 below.

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<sup>12</sup> RPI is the Retail Price Index and the X refers to the general efficiency or productivity factor set for the service provider.

**Box 1: Office of Utility Regulation (OUR) Jamaica**

The Office of Utility Regulation<sup>13</sup> (OUR) in its 2003 Determination for the National Water Commission (NWC) established a number of targets including the following:

- Employee costs not to exceed 35% of revenues (within two years of determination).
- Unaccounted for water to be reduced to 55% by the end of fiscal year 2004/05 and thereafter by at least two (2) percentage points per year.
- Collection rate to be 92% of billed revenues.
- Water quality compliance to be 99% of the IJAM standards.

In its 2018 Review it targets included the following:

- Non-Revenue Water not to exceed 70% of total water production by the end of the target period in 2022.
- Collection rate to be 92% by 2022.
- Water quality compliance to be 99% of the IJAM standards.

**Box 2: The Water Services Regulation Authority (Ofwat)<sup>14</sup>**

Ofwat, established the following targets in 2005:

- Improvements at 227 water treatment works and replacement, relining or cleaning of 22,000 km of distribution mains to achieve compliance with drinking water standards.
- Cleaner effluent from 1,043 sewage treatment works, and improvements to 2,005 intermittent discharges leading to less pollution of the environment.
- A programme of nearly £1 billion to safeguard homes against the risk of sewer flooding. This was expected to resolve or mitigate every known high-risk problem of internal flooding from overloaded sewers by 2010. By then, the proportion of properties at risk would reduce to 0.01% of households.

In 2019 its targets included:

- Helping customers cut water use by up to 13%
- Cutting leakage by 16%.
- 12% average drop in water bills over the five-year period.
- A reduction in the number of properties being flooded by wastewater from sewers.
- £469 million to address long-term drought challenges

**Comments are invited on use of specific targets as a means of improving performance for public sector Service Providers.**

<sup>13</sup> The Office of Utility Regulation (OUR) is responsible for regulating the water and waste-water sector (among others) in Jamaica.

<sup>14</sup> The Water Services Regulation Authority, or Ofwat, is the body responsible for economic regulation of the privatised water and sewerage industry in England and Wales

## 3.2 Governance Initiatives

A key cornerstone for improving the performance of state-owned and operated entities is strengthening the governance framework within which the entity operates. This may also include high level reforms such as, subjecting the enterprise to company law, external regulation or even listing a minority of shares on the stock exchange. Indeed, for incentive-based regulation to work, it is essential that managerial incentives are available for out-performance of targets, that is, governance initiatives which create appropriate internal organizational incentives for improved performance.

There are two key initiatives in this regard:

- **The establishment of a hard budget constraint**<sup>15</sup> – that is, if a utility spends the financial resources made available in its regulatory determination without achieving the required outputs then the customers are not made to pay twice to meet the cost of remedying same (this is explained further below); and
- **Performance-related pay (PRP)** – that is, tying managerial pay to company performance.

### 3.2.1 Hard Budget Constraint

One of the key elements of incentive-based regulation is ensuring that the regulated utility faces a hard budgetary constraint. To be fully effective, the tight budgetary constraint requires detailed scrutiny of the level of service and outputs that are actually delivered, as well as a limit on the resources that are available to deliver that level of service. Regulators set price or revenue caps to create such constraints. Privately-owned regulated companies are subject to pressure from shareholders to outperform the regulatory settlement. It is this pressure that forces management to seek to improve efficiency which is eventually passed on to customers in the form of lower

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<sup>15</sup> Typically, when a service provider faces a hard budget constraint it means that they must cover their costs of production using revenues generated either from the sales of their product or from other financial sources. In the short term, firms facing hard budget constraints may borrow to cover their operating costs. In the long term, however, if firms cannot cover their costs from their revenues, they fail, which means they must declare that the company is bankrupt or they must sell their assets to another firm. Hard budget constraints coincide with a situation where government authorities do not bail-out or subsidise poorly performing or loss-making firms. The discussion in this section draws on the same tenets but applies it to a regulatory environment.

prices. In effect, the regulator sets the minimum level of performance and the incentives in the framework to induce the utility to outperform the regulatory contract.

Where regulators oversee privatized companies, such as in the United Kingdom, they do not increase prices to compensate for a failure by a regulated company to meet its obligations under the regulatory contract. As a result, there is no danger that customers would be asked to pay twice for the same promised improvements. Shareholders bear the risk. Under the public sector model there is no equity buffer and the risk may be borne by the government.

In the case of a publicly-owned and operated utility, a hard budget constraint would mean that if the service provider were to spend the financial resources made available via a price determination without achieving the required outputs, then it should not be allowed to increase its borrowing to meet this shortfall; the government (as shareholder) would be liable to meet the costs of remedying this through the public purse. Customers must not pay twice through rates for a promised benefit. The service provider must understand that there can be no recourse to customers being asked to bear the cost in the event of its failure to deliver the agreed levels of service and investment outputs. A hard budget constraint will force the service provider to be more aggressive in collecting receivables, linking investment more closely to profitability, and shifting objectives from simply meeting output targets to achieving an operating surplus at the end of the fiscal year. Establishing proper financial discipline is critical to ensuring that the service provider meets and out-performs the regulatory obligations.

Ultimately, for a hard budget constraint to be applied effectively, government must accept that a state-owned and operated service provider should be subject to no less financial discipline than its commercially owned and financed counterparts.

**Comments are invited on the importance of establishing a hard budget constraint for a public sector monopoly**

### 3.2.2 Performance-related pay (PRP)

An important component for ensuring that the service provider delivers on the regulatory contract, especially in the public sector context, is ensuring that the interests of management are aligned with the required levels of performance. This can be done through performance-related pay (PRP).

PRP ties managerial pay to company performance. In private organizations (for-profit), equity-based pay/stock options link remuneration to the company's profitability. However, management pay can also be easily linked to quality, safety, service delivery or other aspects of the company's financial performance. To be effective, the financial incentives need to be both well aligned with the objectives set for an organization, and of sufficient value to provide a real incentive to management.

In the UK, companies like Network Rail and Glas Cymru,<sup>16</sup> which are subject to incentive regulation but do not have shareholders, have sought to implement PRP schemes to provide incentives to their managers to improve performance. There are two key characteristics of these schemes. The first is a high level of transparency not only in their operation, but details of the schemes are made available to their customers and the public at large via the companies' websites. The second is that the schemes align the incentives of management with the interests of customers. These are critical elements which must be adhered to if such schemes are to be utilized locally. Additionally, in the case of Network Rail, it is the regulator which requires that the entity operate such a scheme under the terms of Network Rail's License. While Network Rail determines the structure of the scheme, it is subject to confirmation by the regulator that the scheme meets the requirements of the license.

It is recognized that if such a scheme were to be operated in the context of a publicly owned and operated business its structure would have to be determined by the Government and Board of the

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<sup>16</sup>Network Rail is the company which runs, maintains and develops Britain's rail track, signaling system, rail bridges and tunnels etc. In its '2019-2020 Annual Performance Related Pay Scheme', the methodology for PRP is outlined for both executive and non-executive levels of staff. Glas Cymru is the company which owns Dwr Cymru, the Welsh Water Company. The PRP scheme is outlined in 'PR19 Putting the Sector Back in Balance: Dividend Policy and Performance Related Pay'

utility. However, the RIC, as in the case of the regulator for Network Rail, would likely reserve the right of approval to such a scheme, lest it lead to perverse incentives or undesirable outcomes. Additionally, the RIC is also cognizant that from a customer/stakeholder perspective PRP, especially performance related bonuses, is likely only to be tolerated in response to perceptible and sustained improvements in service. Hence, in order to encourage both out-performance of the regulatory contract and customer support, any approach should be founded on the principle of bonuses being paid only if the utility exceeds the level of performance to be set by the RIC in its Final Determination. Moreover, the utility would have to demonstrate that any proposed management incentive scheme would be objectively measured and be transparent in its implementation.

Alternatively, it can be argued that failure to achieve certain key targets should manifest itself in pay-cuts for key managerial staff. The National Water and Sewerage Corporation<sup>17</sup> in Uganda (NWSC) operates a system whereby the board can reward as well as penalize management for the utility's performance level. These rewards/penalties are usually in the form of annual salary adjustments and are based on performance appraisal systems. This is a sensitive issue and the RIC understands that both the Government and the Board of WASA will have to consider any such impositions against the terms of industrial relations agreements as well as individual contracts that may exist.

The RIC is also aware that if a PRP scheme similar to the one utilized by the NWSC were to be implemented and managers were required to forfeit part of their basic salary for poor performance, then they must be given the tools necessary to improve their performance. Consequently, such a scheme should be accompanied by reforms which promote managerial autonomy and appropriate monitoring and evaluation programmes.

**Comments are invited on the merits of utilizing performance related pay as an incentive mechanism for the Water and Sewerage Authority.**

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<sup>17</sup> Details of this PRP scheme are outlined in the 2015-2018 Performance Contract between the Government of Uganda and NWSC

### **3.3 Other Incentive Mechanisms**

There are also a number of other innovative incentive mechanisms which have been developed by other regulatory agencies. One such example is the inclusion by the UK Civil Aviation Authority (CAA) of certain “triggers” or price cap conditions within its price cap formula for the airports in the UK<sup>18</sup>. The key “trigger” will be introduced to provide a threshold for airport charges above which the airport will be required to explain and justify the price increase to the CAA. In such cases, where the CAA is not satisfied with the airport’s justification of the higher price, a full investigation could be launched.

Such an approach can be easily adapted to WASA for the delivery of critical projects or tied to WASA’s lack of attainment of key deliverables in the RIC’s Final Determination. The quantum which should be forfeited would need to be carefully considered as one would not want to jeopardize the fulfillment of other obligations.

**Comments are invited on the use of triggers to tie a service provider’s lack of performance in key areas to its ability to take up price limits set in the determination.**

**Suggestions are invited for other mechanisms which may not have been considered by the RIC.**

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<sup>18</sup> Analysis provided in the Oxera report ‘Light Touch or Right Touch- An International Review of Airport Regulation, May 2013’ compares the economic regulatory regimes at seven international airports, looking at their incentives for investment and financing