From government-driven to commercially-driven mergers: changing drivers for upscaling in the Dutch water supply sector

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Abstract

Over the past century the Dutch water supply sector has undergone a process of upscaling in which the number of utilities dropped from 230 in the late 1930s to 14 in 2007. Although the policy of upscaling service provision has been continued over this period, the driving forces behind the upscaling process have changed from government-steered upscaling to mergers which are initiated and executed by the water utilities. The shift in driving forces reflects two interlinked changes in the Dutch water supply sector. First, it highlights a shift in objectives that public water utilities are expected to achieve. The government-driven mergers in the first part of the 20th century focused on expanding service coverage to the unserved population. The mergers of the past decade highlight the increasing emphasis on efficiency and “market position”. Secondly, the change in driving forces behind the mergers in the Dutch water supply sector, as illustrated by the case of Friesland, reflect the shift to a “new model of public management” in the water services sector in which public water utilities are expected to operate as autonomous agencies and on the basis of commercial principles (meaning that economic considerations for mergers predominate).

Keywords: Mergers; Netherlands; Water supply sector

1. Introduction

In the past decades, discussions concerning a “bureaucratic” model of public management versus a “New Public Management” model have been plentiful in the field of public management and public administration. Hughes (2003: 256), for example, argues that the bureaucratic model is “obsolete and has effectively been replaced by a new model of public management. This change represents a paradigm shift from bureaucracy to markets […]” (see also Aucoin, 1990; Barzelay, 1992; Borins, 1997; Lane, 2000;
Du Gay, 2000). This position is not shared by everyone, however. Pollitt (2003: 32–33) has argued against the idea that “traditional bureaucracy” ruled the earth, “like some ponderous dinosaur”, prior to the advent of the New Public Management. Pollitt’s view is echoed by Lynn (2001), who expresses doubt about the existence of the “bureaucratic paradigm”, which supposedly dominated the public sector prior to the onset of the New Public Management. Although the views of Lynn and Pollitt are most likely to be correct and unlikely to be contested by many, it has not stopped an array of authors from actually portraying developments in public management in the same bureaucratic model–New Public Management dichotomy that Hughes (2003) observes. Whereas Pollitt and Lynn question the idea of a paradigm shift by emphasizing that both models coexisted for many years, other authors stress that “it is both misguided and remarkably premature to announce the death of the ethos of the bureaucratic office” (also Hood, 1995; Du Gay, 2000: 146; Gow & Dufour, 2000; Manning, 2002; Goodsell, 2004).

Although this article does not seek to revisit the “bureaucratic model versus NPM” discussion, the shift to a new model of public management, as suggested by Hughes, does provide a framework for the analysis of mergers in the Dutch water supply sector presented in this article. The shift to new models of public management is used to explain the drivers for mergers in the Dutch water supply sector over the past 50–80 years. The article shows that these mergers have changed from government-steered mergers to mergers that are initiated by the management of the water utilities themselves. This shift, it is argued, reflects the change from government-led provision of water services to a situation in which public utilities operate as autonomous agencies on the basis of commercial principles. In line with the shift of drivers behind the mergers, the main basis for the decisions has also shifted from focusing on ensuring adequate and universal provision of the service, to increasing efficiency of service delivery and maintaining or improving the “market position” of the utility.

Analysing the drivers behind the mergers in the water sector is done by examining the case of water service provision in the Province of Friesland. Between 1922 and 2006, six different mergers can be identified in which the water utility providing services in that province was involved.

2. Water supply services in the Netherlands

Provision of water services in the Netherlands has changed considerably over the past decades. Initially, development of these services was triggered by increasing urbanization and industrialization, and by better understanding of waterborne diseases in the second half of the 19th century. Provision of water services was left to local initiatives either by municipalities or private operators usually servicing a single city or town. At first, service provision was limited to the larger and richer municipalities where the municipality and private service providers were ensured of sufficient rates of return on their investments. In this era of “local initiative”, which lasted from the early to middle 20th century, the number of municipal and private utilities providing water services grew rapidly. Just before the Second World War the number of water utilities operating in the Netherlands reached a high of almost 230 (mainly private and municipal) water utilities (Schwartz & Blokland, 2002). Currently only 10 water utilities remain, indicating that the water supply sector has gone through a process of upscaling in the past 60 years. Figure 1 shows numbers of water utilities over the last 150 years or so.

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Over the past 80 years, the inhabitants of Friesland have received water services from a number of public water companies, which operated at a variety of scales. From an initial private utility in 1889 which covered only the city of Leeuwarden, water services are now being provided by a government-owned water company which in 2006 serviced 5.4 million customers in five provinces. This change is the result of a series of mergers, which occurred over the past century. Below the establishment of the Intercommunale Waterleidingmaatschappij Gebied Leeuwarden (IWGL) (1922), the Waterleiding Friesland (WLF) (1974), the merger with NUON (1999) and the merger to create VITENS (2002) will be discussed in greater detail.

3.1. Establishment of the Intercommunale Waterleidingmaatschappij Gebied Leeuwarden (1922)

Initially, water services in the capital city of Friesland, Leeuwarden were provided by a private water utility, which commenced operations in 1889. Following the termination of that concession\(^2\), however the municipality of Leeuwarden opted for a regional, government-owned utility to provide water services. The choice of a regional utility was based on the knowledge that following the termination of the private concession, substantial investments were required in the system. Two important considerations of the policy makers at that time were highlighted by opting for a regional company, rather than a municipal utility.

The first consideration is financial in nature and is linked to the understanding that the investment costs in the system would be considerable. By opting for a regional utility, these investment costs could be spread out over more municipalities and customers (Blokland, 1999). The second consideration relates to the main objectives that the company would pursue. Opting for a regional utility reflects the emphasis of service expansion that the utility had. By letting the utility operate over a large region, service expansion would take place within the service area of the utility and would not require tedious merger talks with other municipal utilities. Moreover, only a regional utility would be able to address the challenge of expanding

\(^2\) For a discussion on the reasons for terminating the private concession, see Blokland (1999).
services especially to rural areas. Expanding services to rural areas is costly and usually cannot be done on a cost-recovering basis, meaning that these connections have to be subsidized. By opting for one large government-owned utility covering a large service, this water utility had a relatively large capacity to use cross-subsidies to finance service expansion to rural areas (in addition to receiving government subsidies for service expansion to rural areas). A municipal utility would have had much less capacity to expand to rural areas.

The regional water utility, Intercommunale (IWGL) began operations in 1925. Early in the life of IWGL, in 1931, the company received a concession from the Provincial Government of Friesland to provide services to the whole province of Friesland, with the exception of the cities of Sneek and Heerenveen, which already had established municipal water utilities operating in their cities. This meant that IWGL, which in 1931 had grown to providing services to 16 of the 44 municipalities in Friesland, was the only utility which was allowed to expand services over the entire province.

The role of the municipalities in enabling the expansion of IWGL was pivotal. Driven by the understanding that ensuring universal water supply was crucial to the well-being of the population, they joined the water company as shareholders, signed contracts with the company guaranteeing it revenue from their constituencies, passed municipal regulations to make users connect to the system, and approved amendments to the company’s tariff system (Blokland, 1999). In 1947, about 50% of the provincial population was covered. In 1962, coverage had reached 95%. By the end of the 1960s coverage was 100%. In addition to being aided by the provincial mandate that the IWGL had (which meant that all service expansion took place within the confines of its own service area), the rapid expansion of coverage between 1945 and 1970 was facilitated by national subsidy schemes for capital investment enabling the construction of otherwise non-viable extensions to the most remote rural villages and hamlets.

3.2. From IWGL to WLF (1974)

Assisted by the concession which allowed only IWGL to provide services in Friesland, the IWGL soon became the largest water utility in Friesland. In 1954, IWGL took over the water supply system for the city of Heerenveen and from 1959 IWGL supplied water in bulk to Sneek. Full takeover of the Sneek system followed in 1977. Pre-empting this final action, IWGL was renamed NV Waterleiding Friesland (WLF) in 1974, signifying that its supply area from then on was the entire province of Friesland. The achievement of universal coverage in the late 1960s signalled the end of a period of unprecedented growth. Although the supply area hardly expanded between 1945 and 1970, water supply had increased more than fivefold from six to 32 million m$^3$ per year and the number of connections had risen threefold from 48,000 to 159,000. In the subsequent 25 years up to 1995, water demand hardly grew. The historical growth pattern of WLF is shown in Figure 2.

With service coverage being achieved by the end of the 1960s, the priorities of the utility started to change. Rather than service expansion, the utility started to focus on increasing productivity and efficiency. This was done by reorganizing the utility, focussing on personnel management and outsourcing. The organization was restructured to suit company concerns and activities better. Personnel management was driven by policies of zero-hiring, voluntary early retirement and in-house mobility. The tendency for strict control of personnel costs to drive up other direct operational costs, for example by increased out-contracting and hiring of temporary staff, was discouraged by ‘‘sharper’’ budgeting, cost-cutting measures and strict expenditure control. In addition, there was a steady increase in outsourcing.
In the 1970s, the Dutch government had concluded that for a water supply company to meet future challenges of water supply provision, a certain scale needed to be achieved. The government decided that water supply utility should have:

- Appropriate management, expertise and organization
- A laboratory for quality control
- At least 100,000 connections in order to produce potable water on a larger and more efficient scale.

The Dutch government, however, became increasingly frustrated with the pace of upscaling in the water sector and instructed the provinces to reorganize the water supply sector in their province (as the municipalities seemed reluctant to have their municipal utilities merge with other municipal utilities). The result of these provincial reorganizations was a wave of mergers, which swept through the water supply sector in the 1970s and 1980s. This reorganization consisted mainly of merging municipal water utilities into regional government-owned water supply utilities. The boundaries of the service areas of these water utilities were frequently identical to the provincial boundaries.

The wave of mergers in the Dutch water supply sector largely bypassed WLF, which already operated on a provincial scale following the 1931 concession and easily achieved the criteria set by the Dutch government. The mergers did have an impact on the WLF, however. As the municipal utilities merged into larger regional companies, the relative size of WLF decreased. In other words, WLF was becoming one of the smaller water utilities. Taking the produced volume of drinking water as a parameter, the WLF ranked 7th of 142 water supply companies in 1968 and 12th of 42 companies in 1992.

The relative size of WLF and the perceived need to become part of a bigger water utility were the driving forces behind the incorporation of WLF in the multi-utility NUON NV which provided water services in part of the province of Gelderland. This incorporation occurred in 1999, when the shareholders of WLF,

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3 This reluctance can be linked to the fact that for many municipalities the water utilities formed a source of income to finance other municipal expenditures not related to water supply. Having the municipal utility merge with a larger utility would then also be likely to mean an end to the income deriving from the utility.
the municipalities in the Province of Friesland, decided to sell their shares to the NUON NV, doubling the size of NUON NV. The need for WLF to become part of a larger water utility was argued on two main points. The arguments were as follows:

1. The water utility WLF was too small to react adequately to new technological developments in the provision of water services. Developing new water treatment technologies requires considerable investments in innovation and a water utility the size of WLF was considered too small to be able to cover these costs.
2. Upscaling the activities of the utility which are prone to economies of scale would lead to increasing efficiency (and as such to cost savings). Specifically, increased automatization and customer management were seen as activities, which were subject to increasing economies of scale.

The nature of the incorporation of WLF in NUON NV consisted of the sale of all shares which were owned by Frisian municipalities to NUON. As such, this was not so much a merger as it was a buy-out of WLF by NUON NV. The reason the municipalities opted for a buy-out rather than a more traditional merger appears to be twofold. On one hand, the sale of the shares provided the municipalities with a considerable sum of money, which they could invest in other activities and sectors in their municipality. For many municipalities this financial windfall was an attractive perspective. On the other hand, when WLF became part of a larger utility, the average weight of the shares would become smaller (and similarly their influence during the shareholders meeting would diminish accordingly). For a municipality to keep the same amount of influence during a shareholders meeting, the municipality would have had to increase its shares in the new utility. No municipalities saw this as a realistic option.

These reasons are illustrated by a letter from the mayor of the municipality of Tietjerksteradeel concerning the discussions of the sale of their shares in WLF on 23 February 1999. Although the municipality initially positioned itself against the sale of shares, the mayor soon realized it was alone in resisting the sale of WLF to NUON. In this letter the mayor concluded that although the municipality controlled 5.04% of the shares, this would leave the municipality with no influence on the policy of the company. Moreover, the mayor realizes that holding on to the shares, whilst the other municipalities sell theirs, may lead to a substantial financial loss in comparison with the income generated by “immediate sale” of the shares. The letter ends with the advice to all political parties in the municipal council to agree to the sale of shares.

What makes the incorporation of WLF in NUON NV different from earlier mergers is that it was strongly supported and advocated by the management of WLF. Whereas the wave of mergers in the 1970s and 1980s had been driven, if not forced, by government policy (and were to some extent resisted by smaller utilities), the 1999 takeover by NUON NV was strongly supported from within WLF. While previous mergers had been government-driven with the aim of ensuring universal service coverage, the 1999 takeover was strongly supported by management of the WLF and argued on the need to share costs of research and development and on potential efficiency gains.

It is important in this respect is that the buying company, NUON, had its roots in the electricity and natural gas sector rather than the water supply sector. Liberalization of the Dutch energy market is much

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4 The shareholders meeting of WLF agreed to adapt the company statutes to allow for the sale of shares to entities outside Friesland on 4 February 1999. The municipality of Tietjerksteradeel was the only municipality to oppose this change in statutes.
5 In the end the municipal council decided not to sell the shares and the municipality remains one of 114 shareholders of VITENS NV.
further developed than liberalization in the water market and NUON appeared to have a much more competitive outlook than the ‘‘traditional’’ water utilities. As the company stated in its annual report of 2001, NUON believed that the current scale of the company was insufficient to compete with some of the mega-utilities from other countries. ‘‘The size of our competitors shows that further growth is essential’’ \(^6\) (NUON, 2001: 14). NUON also wanted to become a player on the international water market, which it saw as growing at a rate of 10% per year (NUON, 2001). This market was dominated by ‘‘a few, very large companies’’ \(^6\) (NUON, 2001: 12). If NUON wanted to compete in the international water market, it would have to upscale considerably. Taking over WLF could be seen as the first step in this process.

The comparison of NUON with its ‘‘competitors’’ highlights an important change in the water services sector in the 1990s and illustrates the onset of the New Public Management in the water supply sector. Public utilities, which previously had only the task of ensuring service provision to the population it served, now started to concern themselves with ‘‘the market’’ and their place in this market. The emphasis on the competitors and market-position in what is essentially a monopolistic sector signalled the entry of ‘‘quasi-competition’’ in the water supply sector. With this shift, the initiative for reforms and changes in the sector also changed from government-initiated changes to changes pursued by the utilities themselves.

3.4. NUON to VITENS (2002)

Despite the incorporation of WLF in NUON in 1999, the utility was only the fourth largest utility with a total number of connections of 576,000 (VEWIN, 2002: 9). The inclusion of WLF in NUON was soon followed by another increase in scale when NUON merged with Waterleidingmaatschapij Overijssel (WMO) and Waterbedrijf Gelderland to form VITENS.

The two main arguments forwarded by the management of the three utilities to merge were that:

1. The merger would lead to a water utility which would have a ‘‘leading position’’ both in the Netherlands and abroad; and
2. Increased scale and combining knowledge would allow for a more efficient provision of water services.

Similar to the incorporation of WLF into NUON, the merger of the three utilities into VITENS appears to be largely supported by the management of the utility and argued on the basis of potential efficiency gains and the goal of achieving a leading position in the water supply sector, which again reflects the quasi-competition with other water utilities\(^7\).

4. Discussion

What the discussion of the mergers highlight is a shift in the drivers behind the mergers. Initially, mergers were seen as the best way to ensure universal service coverage to the population. Only a utility with sufficient technical, managerial and financial capacity would be able to ensure universal service

\(^6\) Author’s own translation.

\(^7\) The latest chapter in the upscaling of water supply is the merger of VITENS with two water supply companies, Watercompany Flevoland and Watercompany Midden-Nederland. The merger was completed in 2007. The result of this latest merger is a utility that serves about 5.4 million people in the Netherlands, almost one out of three people living in the Netherlands.
coverage. With universal service coverage being achieved in the 1960s, however, this reason for mergers became obsolete. As universal coverage at affordable tariffs was ensured, government-involvement in the water supply sector also changed. Rather than playing a lead-role in the water supply sector (with the aim of achieving service expansion), the role changed to one which focused more on providing an enabling environment and monitoring the sector. This change was largely possible because provision of water services became a less prominent issue on the political agenda. For water not to be prominently on the public agenda, a utility would have to have (Schwartz, 2006):

- a service coverage of 100%
- reliable service provision to the extent that customers are highly satisfied with the level of service provided for them; and
- tariffs at cost-recovery levels, whilst still being low enough for consumers not only to afford them, but also to be willing to pay them.

With universal service coverage in the 1960s these criteria were all fulfilled in the Dutch water services sector. But even satisfying these criteria may not be enough, as other elements can be identified which have depoliticized water services in the Netherlands. Historically, the mayor of a municipality was not elected by the electorate, but rather appointed by the national government for a term that does not run congruently with those of elected municipal council members. This means that the mayor has little incentive to use the water services sector for political gains. Moreover, the Netherlands has never had a “free-water” legacy meaning that there is a long tradition of charging cost-recovering levels (which influences the willingness-to-pay of consumers).

The (limited) withdrawal of the government from the water supply sector encouraged the management of the utilities increasingly to take the initiative in changes and reforms implemented in the utilities. The result is that increasingly these utilities were run on more commercial principles and in a business-like manner (Baietti et al., 2006). Not surprisingly, recent merger decisions appear to have been made mainly on the basis of commercial and economic considerations by the management of the utility. These considerations include the desire to maintain or improve the “market position” of the water utility and to achieve economic savings by reaping the benefits of economies of scale. This shift appears to be in line with what could be expected of a public utility under the New Public Management. As Lane (2000: 14) explains, the “NPM is basically about focusing on efficiency”. Pollitt (2003: 28) echoes this focus of the NPM, by mentioning as a key element of the NPM a “shift in value priorities away from universalism, equity, security and resilience, and towards efficiency and individualism”. The change in the driving forces behind the mergers in the Dutch water supply sector, as illustrated by the case of Friesland, illustrate that this shift has also taken place in the Dutch water supply sector since the 1990s.

5. Conclusion

The Dutch water supply sector has been the subject of a stream of mergers over the past 60 years. These mergers reflect a pronounced change in the way the public provision of water services is organized in the Netherlands. Initially, the emphasis in providing water services was on ensuring universal service coverage. The drive towards full service coverage was spearheaded by the municipal, provincial and
national government. Once universal service coverage was achieved, initiatives for developments in the
sector came from within the water utilities rather than from the government.

From the 1990s onwards these initiatives seem to have been strongly in line with the New Public
Management agenda, which has become increasingly prominent in the water supply sector. Focus shifted
from universal service coverage to increasing efficiency and on “competing” with other water utilities in
order to consolidate (and possibly improve) the market position of the utility. In the case of water supply in
the Province of Friesland, this shift is reflected by the 1999 takeover by NUON.

References


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