Inside the Aggregation of Water Supply and Sanitation Utilities in Southeast Hungary

In a world where 4.5 billion people lack safely managed sanitation services and 2.1 billion lack access to safely managed drinking water services, it is critical to think about ways to improve water supply and sanitation services (WSS). As such, an increasing number of countries and local governments are turning to the aggregation of WSS utilities.

To better understand how WSS utilities can work together ("aggregate"), the World Bank launched a report and online toolkit entitled Joining Forces for Better Services? When, Why, and How Water and Sanitation Utilities Can Benefit from Working Together that shares first-hand experiences with WSS utility aggregation – such as the case of Hungary.

In 2011, the government of Hungary introduced Act CCIX on Water Utility Services, which stipulated a minimum utility size as a precondition to obtaining the operating permit to provide WSS services. This prompted smaller water utility companies to merge with each other or join larger service providers, and overall encouraged a country-wide wave of aggregation. The primary driver for this Act included pursuing economic efficiency, improving service quality, and building technical capacity of small municipalities previously served by small utilities. In this Q and A, László Nagy, deputy CEO of Alföldvíz, and Károly Uhrmann, Financial Director of Alföldvíz, share some of their experiences with WSS utility aggregation in southeast Hungary. Alföldvíz is a water utility company in Southeast Hungary that now serves the consumers of 131 municipalities, as opposed to the 66 municipalities served in 2012. Nagy and Uhrmann have been active participants in the preparation, implementation, and post evaluation of the aggregation.

László Nagy, deputy CEO of Alföldvíz (left) and Károly Uhrmann (right), Financial Director of Alföldvíz, share some of their experiences with WSS utility aggregation in southeast Hungary.

Question: In 2012, the size of Alföldvíz already notably exceeded the threshold level set by the Act. Why did you decide to expand the service area of the company?

László Nagy: We viewed expansion mainly as an opportunity. In our region, prior to 2011, there were a number of small water utilities – some of which served only a single settlement – the operating efficiency of which was below the level of Alföldvíz, either due to their small size, or some other factors. We believed that in these locations we could considerably improve the quality of service while also reducing the level of cost. We also anticipated a drop-in unit cost due to the overall larger size, since central costs can be spread over larger volumes, as well as improved negotiating power for price since we would purchase larger volumes of energy and materials.

Károly Uhrmann: The wave of aggregation that took off in the country also posed a risk. We were afraid that other water service providers in our region might entice some of the settlements that we served. Therefore, our expansion could also be interpreted as proactive defense. If we succeed to expand and serve an increasing size of continuous area, we maintain our image toward our municipalities that we are a strong and stable service provider.

Q: How did you select which municipalities to target?

Károly Uhrmann: First of all, we wished to merge with municipalities that bordered our existing service area. Secondly, we wanted to reduce the risk of negative surprises; therefore, for each of the targeted municipalities, a thorough survey had preceded the negotiations by our dedicated merger team consisting of employees with a diverse set of background. We wanted to have a clear understanding of the condition of the assets, the level of costs, the composition of the workforce, and the potential for efficiency improvement. This appraisal was also the foundation of our rental fee offer to the municipality for the assets owned by them. In many cases, when the financial situation was judged as poor, we offered only a tiny nominal fee.

László Nagy: Occasionally, however, we also took responsibility for settlements with obvious problems or difficulties, even though we knew that it would be costly to improve the quality of service. This was inevitable if we wanted to maintain an uninterrupted service area. Mmoreover, the principle of solidarity was declared in the Act on Water Utility Services specifically because of such situations.

Q: How did the service area evolve as a result of aggregation?

László Nagy: In 2011, we served almost 300 thousand people in 66 municipalities. By 2016, these values increased to over 560 thousand people in 131 municipalities. The volume of sold water rose from 11.5 million m^3 to 21 million m^3, while the quantity of collected wastewater more than doubled in five years. Importantly, as a result of expansion our current service area is more or less continuous with only two smaller water service providers wedged within the area. All other municipalities are served by Alföldvíz.

Q: What was the most important challenge that you faced during the aggregation?

László Nagy: Clearly, the time constraints. The Act of Water Utility Services set strict deadlines to reach the required size. Most small settlements already had to act by the end of 2013, since after this time only those water utilities were eligible for operating permits that served at least 50 thousand “consumer equivalent”. Once the regulation entered into force, less than two years were left to appraise

settlements and service providers, search for partners, negotiate, make agreements, take over assets and employees, etc. We conducted negotiations with dozens of municipalities at the same time, and a lot of municipalities kept delaying the final decision, sometimes until the last moments. In addition to our regular work, managing the aggregation process took a lot of time and energy. During the last few months everybody within the aggregation team accumulated a lot of overtime.

Q: What happened to the staff of water utilities that had worked in the new service areas?

Károly Uhrmann: We hired these people, but not always for the same position as before. Every new hire was interviewed. We selected a position for the person based on his/her professional qualifications, but also in accordance with our needs. We placed a lot of emphasis on training new employees, and even applied a mentor program to make their integration easier. Lower salaries were gradually raised to reach the higher level of Alfoldviz salaries for similar positions. We applied legal continuity; this is important from the perspective of labor law. Overall, the process of integrating the new employees was a smooth one, without real problems.

Q: In retrospect, what were the benefits of expansion?

Károly Uhrmann: The unit cost of providing drinking water services changed favorably, declining by more than 10% between 2012 and 2016. In case of wastewater services, the trend is not so clear-cut. This should not be expected anyway, since here major technological upgrade has taken place for the last few years, and new, modern sewage systems have been constructed with advanced treatment, the operating costs of which – in line with the better quality of the effluents – are also higher. While within Alföldvíz, increased overall efficiency delivered favorable financial impacts, improved profitability has been erased by the regulation that first froze service prices, then reduced water and wastewater tariffs for households and imposed a disproportionately high tax burden on public utilities, including water companies. In view of all these adverse impact,s we can conclude that without aggregation, most of the former, less efficient service providers of our region would have faced financing difficulties endangering basic water utility services.

László Nagy: It is also important to highlight that we have improved and continue to improve the quality of service in the smaller municipalities that have been added to our service area for the last few years. These improvements are not easy to measure, but the consumers can directly experience some of them, e.g. online customer service and the operation of a call center. Other changes contribute to safe, good quality services indirectly, e.g. we apply technologies that had not been available for small municipalities, such as an accredited laboratory, cameras for network inspection, and a GIS database.

Editor's Note:

To learn more about WSS utility aggregation in Hungary, please visit the case study summaries from Hungary here in our online toolkit. To learn more about global experiences and trends with WSS utility aggregation, watch 4 short videos with interviews; read the 14 case studies from Brazil, Colombia, Hungary, Indonesia, Mozambique, Portugal, Romania; visit the Interactive map & glossary of related definitions; and learn with the Statistical Analysis Report and Literature Review.