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Article (Accepted version)
(Refereed)

Original citation:

Molinos-Senante, María and Porcher, Simon and Maziotis, Alexandros (2018) *Productivity change and its drivers for the Chilean water companies: a comparison of full private and concessionary companies*. [Journal of Cleaner Production](#), 183. pp. 908-916. ISSN 0959-6526

DOI: [10.1016/j.jclepro.2018.02.227](https://doi.org/10.1016/j.jclepro.2018.02.227)

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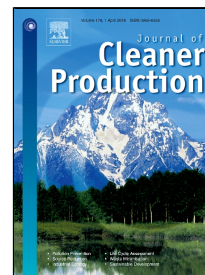
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Accepted Manuscript

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PII: S0959-6526(18)30557-2
DOI: 10.1016/j.jclepro.2018.02.227
Reference: JCLP 12174
To appear in: *Journal of Cleaner Production*

Received Date: 12 June 2017
Revised Date: 19 February 2018
Accepted Date: 20 February 2018

Please cite this article as: María Molinos-Senante, Simon Porcher, Alexandros Maziotis, Productivity change and its drivers for the Chilean water companies: A comparison of full private and concessionary companies, *Journal of Cleaner Production* (2018), doi: 10.1016/j.jclepro.2018.02.227

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Productivity change and its drivers for the Chilean water companies: A comparison of full private and concessionary companies.

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Abstract:

The privatization of the water industry has aroused interest in comparing the performance of public vs. private water companies. However, little research has been conducted to compare the performances of full private (FPWCs) and concessionary water companies (CWCs). This study estimates and compares the productivity growth and its drivers (efficiency, technical and scale change) for a sample of Chilean FPWCs and CWCs over the 2007–2015 period using the input distance function. Both types of water companies showed deteriorations in productivity growth, with CWCs exhibiting higher rates of negative productivity growth than FPWCs. For FPWCs, any gains in efficiency and scale were outstripped by negative technical change. CWCs did not improve their performance in any of the three components of productivity change. The comparison of productivity change between FPWCs and CWCs is

essential to support decision-making therefore, this study is of great interest for policymakers worldwide who are developing policies aimed at privatizing water companies.

Keywords: environmental factors; performance; privatization; productivity growth; quality of service; water and sanitation industry.

ACCEPTED MANUSCRIPT

1. Introduction

Efficient management of water companies (WCs) is essential to ensure sustainable urban water activities. Performance assessments of WCs are relevant and have strong implications for regulators, utilities, customers, and stakeholders (Pinto et al., 2016; Dong et al., 2018). Since the 1980s, many studies have used different benchmarking methods to evaluate and compare the performances of water utility companies around the globe (Haider et al., 2016). Some research has focused on assessing the efficiency of water utility companies through static comparisons of their performance levels (Tutusaus et al., 2018). This approach provides information on WCs assessed at a given moment in time. Alternative studies have evaluated the change in productivity of WCs. Unlike efficiency studies, productivity change studies integrate the temporal component in the assessment (Portela et al., 2011) and focus on how the performance levels of WCs change over time (O'Donnell et al., 2017).

After the pioneering privatization of the English and Welsh water industry in 1989, several countries privatized some or all of their WCs. Since then, there has been controversial debate, politically and scientifically, about the appropriateness of privatizing utilities (Cheung and Chan, 2011). Case studies analyzed in the literature (Megginson and Netter, 2001) evidenced that private sector participation in the water industry is likely to result in improved managerial practices and higher operating efficiency. However, published literature also provides case studies where privatization of water utilities involved negative impacts on the society mainly due to increases in the water tariffs which led to water affordability problems (Al-Madfaei, 2017)¹. Two major issues that have been investigated over the past 20 years include: i) the performance implications of public vs. private ownership

¹ Porcher (2014) studies the impact of privatization on allocative efficiency in the French water industries and find no clear impact, i.e. margins are the same in the public and the private sector.

of WCs (Berg and Marques, 2011; Suárez-Varela et al., 2017), and ii) the change in productivity of WCs before and after their privatization (Saal et al., 2007). Most previous studies focusing on the second issue have referred to private WCs without taking into account that private WCs can be differentiated into two types, full private (FPWCs) and concessionary water companies (CWCs), depending on their approach towards privatization. For FPWCs, ownership, including infrastructure, is privatized, usually by selling strategic participations and shares to private consortia. For CWCs, water and sewerage services are privatized for a certain period of time, such that water regulators enter into long-term contracts with private entities (Petrova, 2006).

For urban planning and from a policy perspective, it is essential to compare not only the productivity change of public vs. private WCs but also of FPWCs vs. CWCs. This comparison will provide relevant information to policymakers regarding the proper approach for privatizing urban water industries. Despite the usefulness of assessing the productivity change of FPWCs and CWCs, to the best of the author's knowledge, only Molinos–Senante and Sala–Garrido (2015) have conducted an empirical case study on this topic. They evaluated the productivity change of 18 Chilean WCs, including FPWCs and CWCs, from 1997 to 2013 by estimating the Luenberger productivity indicator. Although these authors pioneered the estimation of productivity change for FPWCs and CWCs, their paper had several limitations.

To compute changes in the productivity of WCs, parametric or nonparametric methods can be used (Zhang, 2015). The first limitation of the study by Molinos–Senante and Sala–Garrido (2015) regards the use of the nonparametric Luenberger productivity indicator. This approach does not allow for the control of exogenous factors and quality of service. Several papers (see for instance Carvalho and Marques, 2011; Tanner et al., 2018)

evidenced the importance of external variables in the performance assessment of WCs. The second limitation is that the authors decomposed the total factor productivity change (TFPC) into two drivers only: efficiency change (EC) and technical change (TC). This approach assumes that a change in the scale of a WC does not influence the change in productivity. A third limitation regards the presentation and interpretation of results. Molinos–Senante and Sala–Garrido (2015) presented results at the company level without any reference to the type of WC (i.e., FPWC or CWC). Moreover, no analysis was conducted to check the statistical significance of differences in productivity change between the two types of WCs.

Over the last 30 years, the Chilean water industry has implemented several major regulatory and institutional reforms to improve water and sewerage services (Hearne and Donoso, 2005). One of the most relevant reforms was the privatization of WCs, which began in 1998. Unlike in England and Wales, where all WCs were privatized at the same time following a common approach, the Chilean government privatized WCs in two stages following two different approaches (SISS, 2015). In the first stage (1998–2000), the five main Chilean WCs were privatized as FPWCs. Public WCs sold strategic participations to private consortia, with privatization of the public urban water infrastructure. In the second stage (2001–2004), public WCs transferred rights for the exploitation of water and sewerage services for 30 years, leading to CWCs. In 1998, 92.6% of urban customers were supplied by public WCs. In 2015, FPWCs and CWCs combined provided water and sewerage services to 95.8% of customers.

The main objective of this paper was to evaluate if there are any differences in the performance between FPWCs and CWCs. In doing so, we estimated and compared the TFPC values (and its drivers: EC, TC, and SC) of a sample of FPWCs and CWCs. An empirical application was carried out, which focused on the 22 main Chilean WCs (12 FPWCs and 10

CWCs) over the 2007–2015 period which provide water and sewerage services to 98% of the urban population.

To the best of the knowledge of the authors, no study estimate and compared so far the TFPC of FPWCs and CWCs using a robust parametric method that allows for the control of exogenous factors and inclusion of quality of service issues that might influence productivity growth. Another innovation of the paper is the assessment of the impact of SC in the TFPC of FPWCs and CWCs.

Urban planners (local government) and water regulators are responsible for ensuring that the new urban developments have high quality drinking water and sewerage services (Gabrielsoon et al., 2018). Hence, the findings of this study contribute to better understand the dynamic of WCs by comparing the productivity change of FPWCs and CWCs. This information is essential to develop sound policies. Results about the comparison of TFPC and its drivers between FPWCs and CWCs are essential to support the decision-making process in selecting the approach to the privatization of WCs. In the year 2000 alone, 93 countries had municipalities that carried out some form of WC privatization (Petrova, 2006). Hence, it is essential that policymakers make informed decisions to promote the long-term technical and economic sustainability of WCs.

2. Methodology

To evaluate the TFPC of the analyzed WCs and the influence of the quality of services on TFPC, this research follows the methodological approach proposed by Saal et al. (2007) (Figure 1).

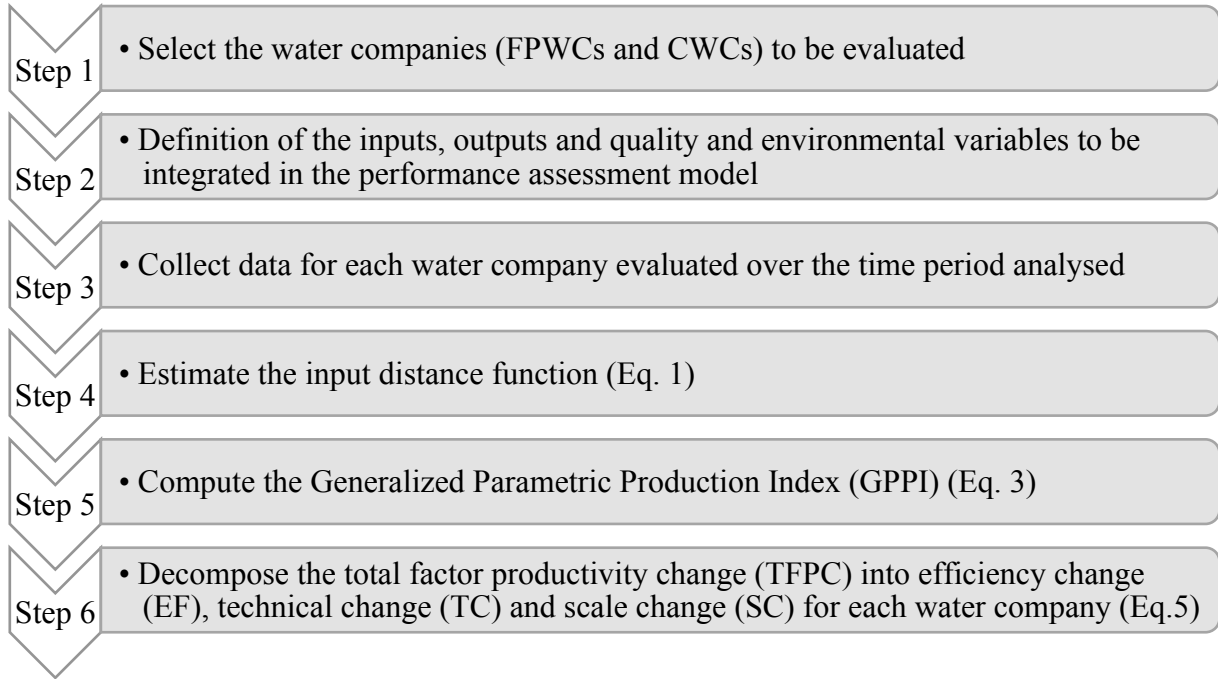


Figure 1. Main steps to evaluate and compare the TFPC and its driver for FPWCs and CWCs

Some previous papers (e.g., Antonioli and Filippini, 2001; Bottasso and Conti, 2009) estimated cost functions to evaluate both the productivity growth and profit change of WCs. By contrast, the present study applies the distance function approach, because there are no available data about all input prices to build a cost frontier and therefore, this study focused on assessing the TFPC of WCs. Following Orea (2002), Mugisha (2007), and Mellah and Ben Amor (2016), among others, this study uses the input distance function to characterize a production technology having multiple inputs and outputs.

The input distance function yields the maximum deflation factor that should be applied to an input set x to project it onto the efficient frontier of input set ($I^t(y)$). For output vector y at time t , the input distance function is defined as:

$$D_i(y,x,t) = \max\left\{\delta : \frac{x}{\delta} \in I^t(y), \delta > 0\right\} \quad (1)$$

This function enables computation of the technical efficiency of the WCs because $D_I(x,y,t) = (1/TE_I^{it}) \geq 1$, where TE_I^{it} is a Farrell measure of the input technical efficiency (Ferro and Mercadier, 2016). In accordance with previous studies, this paper uses an input-oriented approach to assess the performance of WCs (Worthington, 2014). This approach involves that performance improves by reducing the use of inputs for a given level of outputs. In the water industry, as in other network industries, the demand of outputs (i.e., drinking water and wastewater treatment services) is outside the control of managers, who mainly act on minimizing the use of inputs for water and sewerage services (Pinto et al., 2016).

Orea (2002) defined the Malmquist parametric productivity index (MPPI) as the weighted index of output change minus the weighted index of input change, employing input distance elasticities to estimate the weights of inputs and outputs. The MPPI is defined as follows:

$$\ln MPPI_I = -\frac{1}{2} \sum_{k=1}^K (\varepsilon_{kt+1} + \varepsilon_{kt}) \left(\ln \left(\frac{y_{kt+1}}{y_{kt}} \right) \right) - \frac{1}{2} \sum_{m=1}^M (\varepsilon_{mt+1} + \varepsilon_{mt}) \left(\ln \left(\frac{x_{mt+1}}{x_{mt}} \right) \right) \quad (2)$$

where $\varepsilon_{kt} = \partial \ln D_I(t) / \partial \ln y_k$ and $\varepsilon_{mt} = \partial \ln D_I(t) / \partial \ln x_m$.

$D_I(x,y,t)$ is homogeneous of degree one in inputs; therefore, the weights of the input change must sum to unity. By contrast, the output weights do not sum to unity (Saal et al., 2007) due to the effects of non-constant returns to scale. Increasing returns to scale involve economies of scale because an expansion of output can be achieved with a less-than-proportionate increase in all inputs. If outputs increase by less than the proportional change in inputs, then there are decreasing returns to scale (Carvalho and Marques, 2015).

Saal et al. (2007) modified the MPPI so that the output weights were non-negative and summed to unity by definition, and the input weights were non-negative and summed to

unity because of the homogeneity of degree one of the input distance function. Hence, it integrates in the assessment economies of scale. The generalized parametric productivity index (GPPI) which is defined as follows was applied in this study:

$$\ln GPPI_I = \ln MPPI_I + \frac{1}{2} \sum_{k=1}^K \left(\left(\frac{\varepsilon_{kt+1}}{\sum_{j=1}^K \varepsilon_{jt+1}} \right) + \left(\frac{\varepsilon_{kt}}{\sum_{j=1}^K \varepsilon_{kt}} \right) \right) \left(\ln \left(\frac{y_{kt+1}}{y_{kt}} \right) \right) - \frac{1}{2} \sum_{m=1}^M (\varepsilon_{mt+1} + \varepsilon_{mt}) (\ln (x_{mt+1} + \varepsilon_{mt})) \quad (3)$$

Following Caves et al. (1982), to implement the GPPI, the quadratic identity lemma is applied to the input distance function, as follows:

$$-\ln \left(\frac{D_I(y,x,t+1)}{D_I(y,x,t)} \right) \equiv -\frac{1}{2} \sum_m (\varepsilon_{mt+1} + \varepsilon_{mt}) \left(\ln \left(\frac{x_m^{t+1}}{x_m^t} \right) \right) - \frac{1}{2} \sum_k (\varepsilon_{kt+1} + \varepsilon_{kt}) \left(\ln \left(\frac{y_k^{t+1}}{y_k^t} \right) \right) - \frac{1}{2} \left[\frac{\partial \ln D_I(y,x,t+1)}{\partial t} + \frac{\partial \ln D_I(y,x,t)}{\partial t} \right] \quad (4)$$

Given that the input distance function is the inverse of the Farrell technical efficiency, then $-\ln D_I(t) = \ln TE_I(t)$, and the TFPC is decomposed into three components:

$$TFPC = EC + TC + SC \quad (5)$$

Following Saal et al. (2007), this paper uses the translog approach to estimate the input distance function, where i and t are units (WCs) and time indices, respectively. There are M inputs x_m , $m = 1 \dots M$, and K outputs y_k , $k = 1 \dots K$, and abbreviating $\tilde{x}_m \equiv (x_m/x_M)$:

$$-\ln x_{M,i,t} = \alpha_i + \sum_m^{M-1} \theta_m \ln \tilde{x}_{m,i,t} + \frac{1}{2} \sum_m^{M-1} \sum_n^{M-1} \gamma_{m,n} \ln \tilde{x}_{m,i,t} \ln \tilde{x}_{n,i,t} + \sum_k \pi_k \ln y_{k,i,t} + \frac{1}{2} \sum_k \sum_l \beta_{k,l} \ln y_{k,i,t} \ln y_{l,i,t} + \sum_m^{M-1} \sum_k \phi_{m,k} u_{i,t} \quad (6)$$

$u_{i,t}$ are stochastic errors (assumed to measure inefficiency), drawn from an independent half-normal distribution that is truncated at zero. The term $\sum_p \xi_p z_{p,i,t}$ captures the impact of p environmental and quality variables on input requirements, allowing the estimated input

distance function to capture better the true relationship between inputs and outputs (Saal et al., 2007).

Intercept parameter α_i accounts for heterogeneity of the analyzed WCs. This parameter is obtained through the true fixed effect method, proposed by Greene (2005), and it allows for the control of other factors influencing input requirements that have not been specifically controlled in the model. Following Greene (2005), maximum likelihood techniques are used to allow for firm-specific fixed effects and time-varying inefficiency specification. The unknown parameters to be estimated are as follows: $\alpha_i, \theta_m, \gamma_{m,n}, \lambda_k, \beta_{k,l}, \phi_{m,k}, \psi_1, \psi_2, \eta_m, \kappa_k$, and ξ_p .

3. Sample and Data Description

Statistical information from the WCs evaluated was extracted from the management reports of water and sewerage services published by the national urban water regulator (Superintendencia de Servicios Sanitarios, SISS) from 2007 to 2015.

Chilean WCs are multi-output producers, providing water supply and wastewater collection and treatment services. Following past evidence (Molinos–Senante et al., 2016a; Pinto et al., 2016; Li and Phillips, 2017), this study considered two outputs: i) the volume of water distributed, expressed in thousands of cubic meters of water produced annually, and ii) the number of customers with access to wastewater treatment services. Three inputs were assessed: i) the main length, defined as the sum of the water and sewerage networks (in km), which was used as a proxy for capital costs (Ananda, 2014, Ferro and Mercadier, 2016); ii) operating costs (Chilean pesos/year), defined as the total operating costs of the water and sewerage industries, deflated by the consumer price index taken from national statistics; and

iii) number of employees, which represents labor input expressed as the number, not cost, to impose the homogeneity assumption. Environmental and quality of service variables that are expected to influence TFPC were: i) customer density, defined as the number of customers per length pipe (customers/km); ii) nonrevenue water, defined as the percentage of water that was produced and not charged due to real and apparent losses (Neamtu, 2011); iii) drinking water quality; and iv) wastewater treatment quality. Nonrevenue water was included because Molinos–Senante et al. (2016b) found that most Chilean WCs have not solved their large nonrevenue water problems. The last two variables were measured by the water regulator as quality indicators between 0 and 1, with a value of 1 indicating that the water company met all legal requirements regarding the quality of drinking water (e.g., concentrations of pollutants) and the quality of wastewater treatment (e.g., sampling issues). Table 1 shows average values of data used to evaluate TFPC values for FPWCs, CWCs, and the whole sample of water companies from 2007 to 2015.

1 Table 1. Average of the inputs, outputs and environmental variables of the 22 Chilean water companies evaluated.
 2 Source: Own elaboration from Superintendencia de Servicios Sanitarios data.

		Inputs			Outputs		Quality and environmental variables				
	Year	Operational costs (10 ³ CLP/year)*	Network length (km)	Number of employees	Water distributed (m ³ /year)	Customers with access to wastewater treatment	Non-revenue water (%)	Customers density (Customer/km)	Drinking water quality	Wastewater treatment quality	
5	Full private water companies	2007	23,397,348	3,748	625	60,486	788,246	30	53	0.867	0.970
		2008	22,832,776	3,818	630	60,598	812,300	31	54	0.932	0.967
		2009	23,745,518	3,842	642	61,031	831,005	31	54	0.931	0.996
		2010	28,792,440	3,902	660	62,037	892,262	32	55	0.973	0.973
		2011	30,171,184	3,942	651	64,406	904,867	31	55	0.964	0.948
		2012	30,361,100	3,990	677	65,401	896,116	32	56	0.964	0.958
		2013	33,690,775	4,035	669	66,424	919,928	32	57	0.961	0.943
		2014	35,505,561	4,070	698	67,750	944,041	31	58	0.963	0.990
8	2015	32,414,941	4,122	722	68,602	968,138	30	59	0.983	0.962	
9	Concessionary water companies	2007	11,107,588	1,695	347	18,260	304,470	31	55	0.91	0.974
		2008	11,129,458	1,755	356	18,637	315,087	31	55	0.942	0.988
		2009	14,879,487	1,777	379	19,110	324,875	30	55	0.961	0.987
		2010	15,556,148	1,810	389	19,463	345,596	31	55	0.985	0.976
		2011	16,359,463	1,865	393	22,092	353,143	29	55	0.98	0.961
		2012	17,627,481	1,884	403	21,442	338,755	28	54	0.984	0.956
		2013	19,291,969	1,907	425	21,970	347,514	28	55	0.991	0.986
		2014	20,982,211	1,927	448	22,365	355,472	28	55	0.984	0.986
11	2015	22,645,793	1,968	466	22,937	362,952	28	55	0.988	0.987	
12	Total sample of water companies	2007	18,053,974	2,855	497	42,127	577,908	30	54	0.886	0.972
		2008	17,744,377	2,921	504	42,354	596,120	31	54	0.936	0.976
		2009	22,151,591	2,944	521	42,804	610,948	31	54	0.944	0.992
		2010	23,037,530	2,992	536	43,527	654,582	31	55	0.978	0.974
		2011	24,166,087	3,039	533	47,096	664,987	30	55	0.971	0.954
		2012	24,824,744	3,074	551	46,280	653,785	30	55	0.973	0.957
		2013	27,430,424	3,109	557	47,096	671,052	30	56	0.974	0.962
		2014	29,191,061	3,138	584	48,017	688,142	30	57	0.972	0.988
14	2015	28,167,485	3,179	605	48,747	705,013	29	57	0.986	0.973	

16 * Operational costs were adjusted to nominal CLP by the Chilean Consumer Price Indexes.

17 4. Results

18 Estimated results from the input distance function are reported in Table 2. Firm-specific
19 effects i.e., the intercept parameter α_i , ranged from 3.299 to 3.663 for FPWCs and CWCs,
20 respectively. The range of 0.364 suggested that the time-invariant heterogeneity of operating
21 characteristics not otherwise controlled in the model accounted for small but important
22 differences in the input requirements of the WCs.

23 Regarding monotonicity and curvature conditions, the estimated results confirmed
24 that the input distance function was nondecreasing in inputs and nonincreasing in outputs, as
25 shown by their first-order coefficients. The estimated input distance function was concave
26 because the Hessian matrix of the translog input distance function with the second-order
27 coefficients and the interaction term between inputs as elements was negative and semi-
28 definite (Simon and Blume, 1994). There were some violations of the quasi-concavity
29 assumption with respect to outputs. These violations did not imply the absence of an
30 underlying cost-minimization process but may have reflected the inability of the translog
31 input distance function to approximate the true input distance over the range of data (Wales,
32 1977). In particular, 79% (or 21%) of the observations satisfied (or violated) the quasi-
33 concavity assumption in outputs. As Färe et al. (2010) and Wolf et al. (2010) noted, the
34 translog function may lose flexibility when subjected to curvature restrictions.

35 Overall, the estimated translog input distance function was acceptable, and all
36 variables were normalized around their means. Thus, the first-order coefficients of the
37 outputs and inputs can be interpreted as the distance function output and input elasticities,
38 respectively, for the average water company of the sample.

39 Estimated input elasticities were all positive and statistically different from zero,
 40 implying that the distance function was increasing with respect to inputs. Input elasticities of
 41 network length, operational costs, and labor were 0.767, 0.178, and 0.055, respectively.
 42 Number of employees was used as the normalized variable in the distance function. Its
 43 elasticity was recovered from the sum of the elasticities of the network length and operational
 44 costs. This finding suggested that network length and operating costs were the main drivers
 45 of increased input requirements to supply water and treat wastewater. Moreover, the high
 46 network length elasticity implied that the Chilean water and sewerage industry was capital-
 47 intensive.

48 Table 2. Estimated parameters of the input distance function. Labour input is the dependent
 49 variable.

Variables	Parameter	Coeff	St.Error	T-stat
Network length	θ_1	0.767	0.018	41.736*
Operational costs	θ_2	0.178	0.018	9.815*
Water distributed	π_1	-0.309	0.021	-14.537*
Wastewater customers treated	π_2	-0.664	0.022	-29.683*
Time	ψ_1	-0.010	0.002	-6.305*
Network length ²	$\gamma_{1,1}$	-0.693	0.027	-25.803*
Network Length * Operational costs	$\gamma_{1,2}$	-0.013	0.021	-0.594
Operational costs ²	$\gamma_{2,2}$	0.378	0.049	7.768*
Water distributed*Network length	$\phi_{1,1}$	-0.124	0.067	-1.848**
Wastewater treated * Network Length	$\phi_{2,1}$	0.280	0.066	4.214*
Water distributed*Operational costs	$\phi_{1,2}$	0.445	0.055	8.067*
Wastewater treated * Operational costs	$\phi_{2,2}$	-0.528	0.050	-10.619*
Water distributed ²	$\beta_{1,1}$	-0.286	0.031	-9.150*
Wastewater customers treated ²	$\beta_{2,2}$	-0.241	0.029	-8.200*
Water distributed*Wastewater treated	$\beta_{1,2}$	0.254	0.028	8.972*
Network Length * Time	η_1	-0.008	0.002	-4.096*
Operational costs * Time	η_2	-0.013	0.004	-3.101*
Water distributed*Time	κ_1	-0.017	0.004	-4.453*
Wastewater customers treated * Time	κ_2	0.021	0.003	6.377*
Time ²	ψ_2	0.003	0.001	3.693*
Customer density	ξ_1	-2.487	0.027	-92.730*
Customer density ²	ξ_2	0.404	0.007	58.568*
Wastewater treatment quality	ξ_3	-0.479	0.089	-5.356*
Drinking water quality	ξ_4	-0.208	0.027	-7.620*
Non-revenue water	ξ_5	-0.036	0.009	-4.137*
σ		0.144	0.002	48.979*
λ		5.841	0.469	12.435*
Log likelihood function	239.668			
Average technical efficiency	0.912			

50 * Coefficients are significant from zero at the 5% level

51 ** Coefficients are significant from zero at the 10% level.

52 Output elasticities were statistically significant. Thus, providing wastewater
53 treatment to more customers required more input than providing additional volumes of water.
54 This is because increase in the volume of water supplied will take advantage of economies
55 of scale whereas provide wastewater service to more customers will increase operational
56 costs and number of employees (inputs) since the network will be bigger. The scale elasticity
57 (i.e., sum of the inverses of the output elasticities) was 1.027 at the sample mean. In other
58 words, a 1% increase in outputs would require an increase in inputs of 0.973%. Consistent
59 with this result, Ferro and Mercadier (2016) reported increasing returns to scale in the Chilean
60 urban water industry from 2005 to 2013. The second-order coefficient of customers provided
61 with drinking water and wastewater treatment services was positive and significant,
62 suggesting that these outputs were not complementary. This finding was consistent with the
63 results of previous studies carried out in various settings (Saal and Parker, 2006).

64 Elasticities of network length and operational costs were negative and statistically
65 significant over time. Thus, water companies increased capital-investment programs to
66 improve the network, and the operational costs increased the input requirements over time.
67 The estimated coefficient of the time factor was negative and statistically significant,
68 suggesting that the average firm in the sample underwent technological regression at a small
69 rate of 1%. Costs increased annually in part because of technical regress. However, the time-
70 squared coefficient was relatively small and positive, suggesting that the estimated rate of
71 technical change increased at 0.03% per year. Coefficients of time related to each of the input
72 variables were negative and statistically significant, suggesting that water companies
73 experienced technical regress resulting in increasing input requirements with respect to
74 network length and operational costs. The statistically significant parameter of the interaction

75 term between time and outputs suggested that technical change increased the relative
76 magnitude of the number of customers of wastewater treatment services, whereas it decreased
77 the relative magnitude of the elasticity of the amount of water supplied.

78 Density and density squared showed negative first-order and positive second-order
79 terms. This result suggested that as population density increased, the input requirements
80 increased. However, this effect would eventually be exhausted at sufficiently high levels of
81 population density. Therefore, WCs operating in low-density areas might be less efficient
82 than companies operating in high-density areas. In more densely populated areas, the input
83 requirements may decrease because a company with a relatively high customer-to-network
84 length ratio might use shorter pipes and, hence, have lower distribution costs (Torres and
85 Morrison, 2006; Bottasso and Conti, 2009). This finding seemed to confirm the existence of
86 economies of density in the Chilean water industry, consistent with past research in various
87 settings (Kirkpatrick et al., 2006; Picazo-Tadeo et al., 2009; Mellah and Amor, 2016).

88 Elasticities of input requirements with respect to the drinking water quality and
89 wastewater treatment quality were negative and statistically significant. This finding
90 suggested that investments in improving the qualities of drinking water and wastewater
91 treatment led to higher input requirements. Finally, increased nonrevenue water resulted in
92 higher input requirements, which may be attributed to increased investments associated with
93 the detection, repair, and control of water loss.

94 Average TFPC values for the Chilean WCs (Table 3) illustrated notable reductions in
95 values for FPWCs and CWCs from 2007 to 2015. Although TFPC was negative in both cases,
96 it was markedly larger for CWCs than for FPWCs. This finding was consistent with the
97 results of Molinos-Senante and Sala-Garrido (2015), who suggested that Chilean FPWCs
98 exhibited better performance across years than CWCs. For FPWCs, the worsening of

99 productivity was due to the negative shift of the efficient frontier because the average EC and
 100 SC values were positive. By contrast, for CWCs, the three drivers of TFPC (i.e., efficiency
 101 change, technical change, and scale change) were negative. This result suggested that CWCs
 102 did not improve their performance in any of the three components of the TFPC.
 103 Table 3. Average values of efficiency change, technical change, scale change and total factor
 104 productivity change from 2007 to 2015 expressed in percentage.

	Efficiency change (%)	Technical change (%)	Scale change (%)	Total factor productivity change (%)
Full private	0.75	-12.54	3.87	-7.93
Concessionary	-2.14	-5.94	-5.79	-13.89
Total sample	0.48	-9.47	-1.27	-10.26

105

106 To test whether the TFPC and its drivers differed significantly between FPWCs and
 107 CWCs, nonparametric Mann–Whitney and Kolmorov–Smirnov Z tests were carried out. The
 108 null hypothesis was that TFPC, EC, TC, and SC would not be significantly different between
 109 FPWCs and CWCs. The *p*-values for these tests (Table 4) illustrated that the null hypothesis
 110 could be rejected for TC and SC, but not for EC and TFPC. Distributions of the TC and SC
 111 values among CWCs and FPWCs were statistically significant. On the other hand, although
 112 large, the difference in the average TFPC values between FPWCs and CWCs was not
 113 statistically significant. Thus, it cannot be concluded that FPWCs generally presented better
 114 performance across years than CWCs. This finding revealed the importance of verifying
 115 results from a statistical perspective, to avoid obtaining biased conclusions.

116 Table 4. *p*-values of Mann-Whitney and Kolmorov-Smirnov tests

	Efficiency change	Technical change	Scale change	Total factor productivity change
Mann-Whitney	0.863	0.000	0.043	0.618

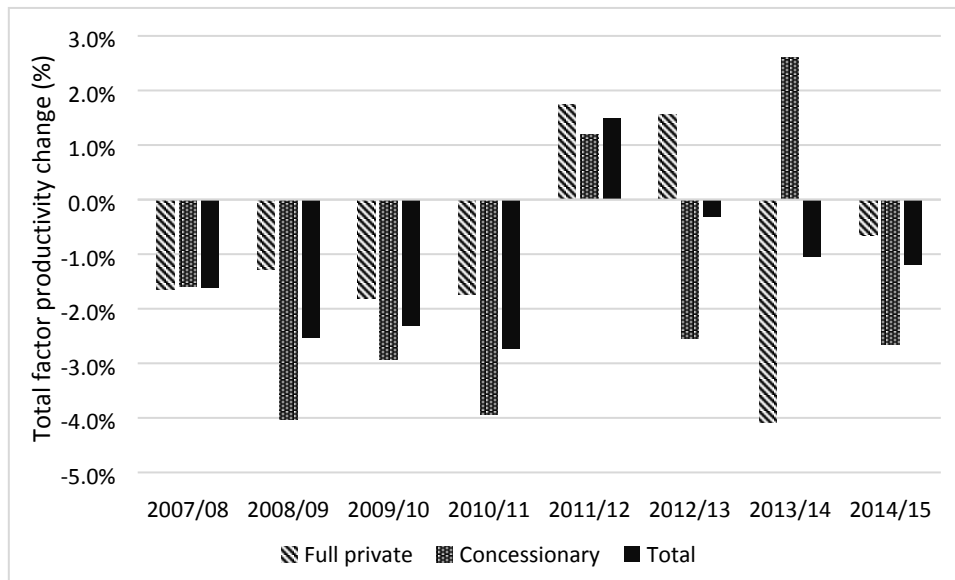
Kolmorov-Smirnov	0.503	0.001	0.031	0.753
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117

118 Next, this paper sought to identify trends in the evolution of the productivity change
119 across years. Figure 2 shows the average values of TFPC for the FPWCs, CWCs, and total
120 sample of WCs evaluated year by year. Detailed results at the company level are reported as
121 supplemental material. The TFPC of the Chilean water companies was positive for only one
122 year, 2011/12. Thus, there was significant reduction of productivity during the period
123 assessed. The increase in the use of inputs was not balanced by growth in the provision of
124 water and sewerage services.

125 Two patterns can be differentiated for the productivity change of FPWCs and CWCs.
126 From 2007 to 2011, although both types of water companies showed worsening productivity,
127 CWCs exhibited worse performance (lower TFPC values) than FPWCs. In particular, from
128 2007 to 2011, TFPC declined by 12.5% and 6.5% for CWCs and FPWCs, respectively. By
129 contrast, from 2011 to 2015, there was no clear pattern in the productivity change of the WCs.
130 From 2012 to 2014, FPWCs and CWCs presented an opposite behavior. In the 2012/13
131 period, the TFPC of the FPWCs increased, whereas CWCs showed a reduction in
132 productivity. During the next year, the opposite behavior was observed; the TFPC of the
133 FPWCs declined, whereas the TFPC of the CWCs showed a positive behaviour.

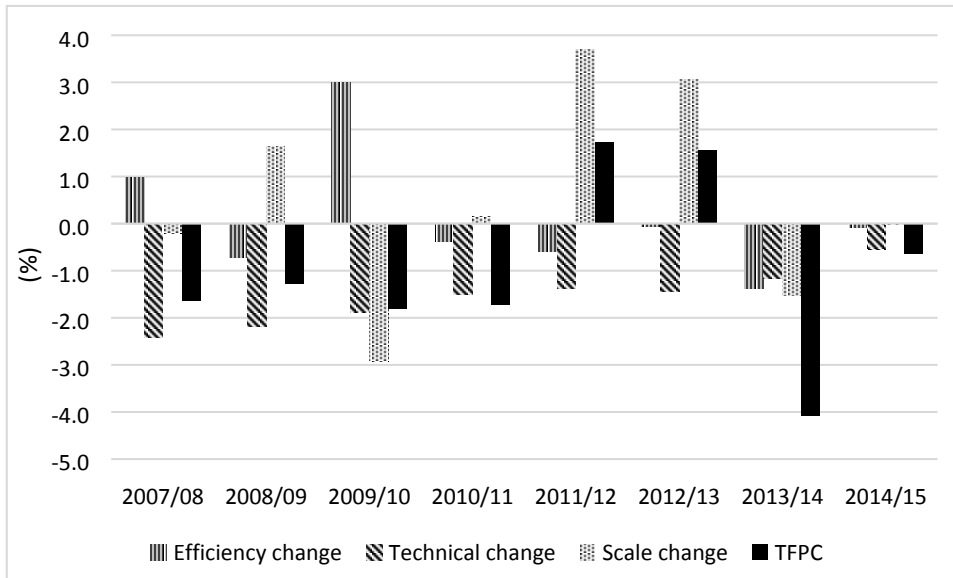
134



135

136 Figure 2. Average values of total factor productivity change for the total sample analyzed,
 137 for full private and concessionary water companies.

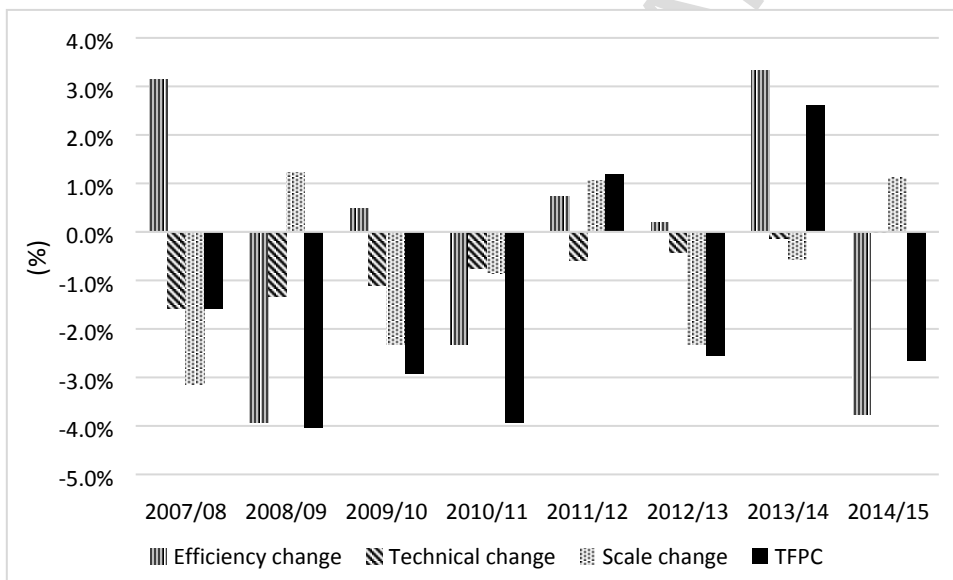
138 To understand better the drivers of productivity change of Chilean WCs, average
 139 values of EC, TC, and SC of the FPWCs and CWCs were plotted (Figures 3 and 4). The
 140 efficiency change, or catching-up index, reflected the capacity of water companies to be
 141 managed on the efficient frontier. Positive values of EC can be attributed mainly to
 142 managerial improvements (Simoes and Marques, 2012). For FPWCs, remarkable
 143 improvement of the EC was observed in the 2009/10 period (2.98%). This improvement
 144 compensated for the small decrease of this driver in subsequent years, leading a positive
 145 average value for the 2007–2015 period. EC showed greater variability for CWCs, with
 146 alternating positive and negative values across years. From a managerial perspective, this
 147 finding means that in average terms, FPWCs made more efforts to adopt better management
 148 practices than CWCs. Nevertheless, neither FPWCs nor CWCs exhibited positive values for
 149 EC in all of the years of the analyzed period. This finding suggested that Chilean WCs did
 150 not implement specific plans for improving management issues in the long term.



151

152 Figure 3. Drivers of the total factor productivity change (TFPC) for full private water
 153 companies

154



155

156 Figure 4. Drivers of the total factor productivity change (TFPC) for concessionary water
 157 companies

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160

The second driver of TFPC, technical change measures the change in the efficient frontier between two periods (Molinos–Senante and Sala-Garrido, 2015). Average TC values of FPWCs and CWCs were negative for all 9 years evaluated (Figures 3 and 4). From 2007

161 to 2015, there was a steady regression of the efficient frontier. In the last years, the
162 deterioration of TC was smaller than at the beginning of the period for both FPWCs and
163 CWCs, but TC remained negative. Regulatory reform is one of the main driving forces to
164 improve TC, making these findings very relevant for urban water regulators. Despite efforts
165 made at the national level by regulators, reforms adopted in recent years were not sufficient
166 to strengthen the Chilean water industry. This deficiency may be due to several reasons, with
167 the small number of WCs providing water and sewerage services being among the most
168 important. Twenty-two WCs supply water to 98% of the urban population. The eight largest
169 Chilean WCs belong to two economic groups that provide water and sewerage services to
170 79% of urban customers. Under this ownership, it is difficult for regulators to introduce
171 reforms to promote competitiveness, innovation, and, therefore, productivity among WCs.

172 The scale change reflects the type of returns to scale presented by the WCs. Positive
173 SC values imply economies of scale, while negative SCs imply diseconomies of scale
174 (Maziotis et al., 2014). Neither FPWCs nor CWCs presented a clear tendency regarding the
175 presence of economies of scale (Figures 3 and 4). For both types of WCs, the SC contributed
176 positively to TFPC in some years but negatively in others. FPWCs had larger variability in
177 SC values than CWCs, as evidenced by the maximum and minimum average SC values of
178 +3.7% and -2.9%, respectively. Such variability in SC is unusual worldwide. Nevertheless,
179 our findings were consistent with previous studies focused on the Chilean water industry,
180 which were inconclusive about the presence of economies of scale (SCL Econometrics 2009;
181 Molinos–Senante et al., 2015; Ferro and Mercadier, 2016). In this context, Ferro and
182 Mercadier (2016) concluded that the different results regarding economies of scale between
183 previous studies were due to differences in methodology. However, the present study
184 suggested that there was inconsistency in the presence of economies and diseconomies of

185 scale for the Chilean WCs depending on the year. In some years, Chilean WCs presented
186 increasing returns to scale, whereas they presented decreasing returns to scale in other years.
187 This issue greatly complicates long-term planning by water regulators because there is no
188 clear sign that favors or disfavors the horizontal integration of WCs.

189

190 **5. Implications**

191 Results (Figure 2) illustrate that the performance of the Chilean WCs changes across
192 years, which may be due to several factors. In the framework of water governance, Berg
193 (2016) identified seven elements affecting water sector performance: ideas, institutions,
194 interests, information, incentives, ideals, and individuals. In the case of the Chilean water
195 industry, FPWCs and CWCs share some of these factors, including institutions, incentives,
196 interests, and ideals. Thus, according to Berg's (2016) methodological framework, the three
197 main factors explaining performance differences between Chilean WCs are ideas,
198 information, and individuals. Ideas are understood as the different conceptual frameworks to
199 support decision-making processes. Data collection, verification, and analysis are essential
200 to identify best practices and establish realistic targets. Finally, leadership is a relevant factor
201 to improve water sector performance (Berg, 2016). Given that the Chilean WCs evaluated
202 are private they do not share a common framework to support decision-making. Moreover,
203 quality of service and efficiency targets are different among WCs. Both issues contributed
204 unequivocally to the different performance between companies.

205 Based on the empirical application carried out in this study for the Chilean water
206 industry, the following policy recommendations are proposed. Firstly, from this study it can
207 be concluded that Chilean WCs (both FPWCs and CWCs) present notable economies of
208 density. It indicates that significant cost savings can be achieved if WCs provide water and

209 sewerage services in compact cities. This means that water companies to better understand
210 the costs to deliver water and treat wastewater between urban and rural areas and develop
211 strategies and make informed decisions to manage their assets more efficiently (e.g. more
212 mains may need to be laid in rural than urban areas) so that they can achieve cost savings in
213 those areas where significant costs exist. Secondly, the results of this study confirm that
214 FPWCs present positive economies of scale which means that if WCs increase their size they
215 can reduce their costs. The opposite occurs for CWCs. Hence, the water regulator should
216 develop policies to encourage the merging of FPWCs forming larger WCs. However, at the
217 same time the water regulator should promote innovation in order to increase the efficiency
218 and quality of service of the WCs. Finally, CWCs have negative efficiency change across
219 years whereas FPWCs presented positive values. This indicates that CWCs have not
220 improved (or have done so to a lesser extent than FPWCs) their operational practices. Hence,
221 the water regulator should introduce incentives for all water companies to adopt the water
222 industry best practices.

223

224 **6. Conclusions**

225 This manuscript contributes to the current strand of literature in two main aspects. It evaluates
226 and compares the productivity change for FPWCs and CWCs. Moreover, it assesses the
227 impact of exogenous factors and quality of service on water companies' efficiency. Finally,
228 it evaluates the impact of efficiency change, technical change and economies of scale in the
229 productivity performance of both types of WCs.

230 The empirical application conducted in this study to compare the performance of
231 Chilean FPWCs and CWCs led to several interesting conclusions. First, FPWCs and CWCs
232 showed reductions in their productivity growth, with CWCs exhibiting higher rates of

233 negative TFP growth than FPWCs. Second, for FPWCs, any gains in EC and SC were
234 outstripped by negative TC. Less efficient FPWCs improved their efficiency relative to the
235 most frontier company, whereas the frontier company did not improve its performance over
236 time. An average FPWC showed increasing returns to scale, suggesting that larger FPWCs
237 can reduce their costs through scale effects (e.g., mergers among FPWCs). It evidenced that
238 water regulators should target policies to encourage the merging of FPWCs forming larger
239 WCs and promoting the adoption of best practices in the water industry. Moreover, CWCs
240 did not improve their performance in any of the three components of productivity change.
241 The major determinants in the deterioration of their productivity were the negative scale
242 effect and TC. Effective long-term strategic planning and timely capital investment are
243 needed to improve the technical efficiency. Hence, the study shows that national-level
244 reforms that have been adopted in recent years have not been sufficient to strengthen the
245 Chilean water industry. In conclusion, despite expending more efforts to adopt better
246 management practices, FPWCs did not perform better than CWCs.

247 From a policy perspective, the findings of this study can be of great importance for
248 researchers, urban planners, and policymakers for several reasons. First, the methodology
249 employed allows the identification of factors that affect productivity change over time, which
250 could aid regulators and managers to define measures that can be employed to improve
251 performance in a regulated industry. Second, the comparison of different types of
252 privatization will allow urban planners and policymakers to make decisions regarding the
253 privatization approach to be taken. Finally, this study will improve understanding on the
254 relative importance of various productivity components, which are essential to policymakers
255 to make informed decisions for the sustainable and efficient management of water
256 companies.

257 As a limitation to our study, we acknowledge that our case study only integrates four
258 environmental and quality of service variables. This is due to the limited number of Chilean
259 WCs. Future research should evaluate the TFPC on a larger sample of water companies which
260 will allow to integrate additional environmental and quality of service variables that may
261 affect the performance of both FPWCs and CWCs. Moreover, as future research we will
262 extend our database by including information on prices for inputs so we can estimate and
263 decompose productivity growth by using cost frontier approaches.

264

265 **NOMENCLATURE**

266 CWCs: concessionary water companies

267 EC: efficiency change

268 FPWCs: full private water companies

269 GPPI: generalized parametric productivity index

270 MPPI: Malmquist parametric productivity index

271 SC: scale change

272 TC: technical change

273 TFPC: total factor productivity change

274 WCs: water companies

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HIGHLIGHTS

The productivity of full private and concessionary water companies was compared over the 2007-2015 period.

Stochastic frontier techniques were used to compute productivity and its drivers

Drinking water and wastewater treatment quality along with non-revenue water contributed significantly to the productivity regression

Full private and concessionary water companies presented positive and negative economies of scale, respectively.