



The Capable Cities Index: Performance

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The Performance Index

The Performance Index (PI) is the last of the three indices that collectively comprise the Capable Cities Index (CCI). The other two components, the Compliance (ComI) and Capacity (CI) Indices, were published earlier this year. The series will be concluded with the publication of an index that combines the three indices into composite index. This Capable Cities Index provides a means to compare the overall sustainability of municipalities in terms of how well they are managed.

The *PI* is, in turn, an amalgamation of the ranking of all municipalities (categories A, B and C) against 3 measures of performance, covering the period 2010 to 2014. The *PI* (as does the CCI) rests on three assumptions:

1. Effective performance of municipalities needs to be measured against those variables which focus on how well the municipality is managed,
2. These measures must be based on outcomes under the operational control of municipality itself, and
3. Trends need to be measured over a period sufficiently long to ensure that anomalies are not overly influential.

The measures selected thus exclude variables which reflect the impact of the external environment like the broader socio-economic or political conditions.

With respect to performance municipalities have control over three key outcomes which are used in this last component of the index.

- **Repairs & Maintenance:** The level of spending on maintaining existing assets. Treasury has set a benchmark of eight percent of the value of property, plant and equipment being spent on repairing and maintaining those assets. Lower levels of expenditure imply that existing assets are being allowed to lose value prematurely.
- **Debt level:** Service providers should be paid for their services within the stipulated period. The failure of service providers to ensure they are timeously paid gives rise to increased debt levels that undermine the municipality's financial sustainability. The second key indicator of municipal performance is the amount of money clients of the municipality owe it. This is expressed as the ratio between debts and service charges.
- **Management cost growth:** Effective management of municipalities requires that services are paid for and that the delivery of such services and the receipt of payment is performed efficiently. The third indicator of municipal efficiency is whether the cost of managing services (and obtaining revenue) rises slower than the amount of revenue accruing to the municipality. If management costs rise faster than revenue it suggests that inefficiency of the management is rewarded. This component is measured by the difference in the rate of growth between a) the wage bill for political officers and senior management and b) the revenue that the municipality accrues from providing services.

Each of the three variables are well within the control of local municipalities and,

collectively, reflect the extent to which assets are maintained, services are paid for and how efficiently this is done. The performance measures do not depend on external factors like the level of grants provided by the national treasury or wider socio-economic conditions.

The specific measures used in the Performance Index are:

- The difference in a) growth of remuneration of political officers and senior managers and b) the growth in municipal own revenue over the period 2010/11 to 2013/14.
- Average value of debts as a percentage of service charges for the period 2010/11 to 2013/14.¹
- Average amount spent on repairs and maintenance expressed as a percentage of the value of property, plant and equipment (PPE).²

All municipalities are scored on a scale of zero to one where higher scores correspond to better/preferable situations. The highest score invariably reflects the most desirable outcome. For example, the municipality where growth in remuneration exceeded growth in own revenue by the highest margin was scored 0 as this is the least desirable situation. Where the gap was smallest (and possibly negative) the municipality scored 1.

Each of the three variables, were thus scored on the 0 to 1 scale. They were then summed to give the composite performance score. This aggregated “composite” score was, in turn, reset to the 0 - 1 scale.

The data was sourced from the detailed data and benchmarking statistics published by the National Treasury's MFMA unit.³

More than half of the 278 municipalities have a better *PI* score

Diagram 1 below indicates how the composite indices of performance are distributed on the spectrum of scores. As indicated above municipalities with greater performance levels are indicated by a higher score. The median *PI* index score of all 278 municipalities is 0.66. Half of all municipalities get more than this value.

A wide variation in performance levels can be seen with four distinct trends/categories of performance evident. These trends correspond to

- the dozen or so municipalities which perform well on all the subcomponents,
- a large group of 169 municipalities that obtained a score of 0.59 or more (but less than 0.85),
- a cluster of approximately half the size of group 2 that obtained scores between 0.59 and 0.37, and
- a group of 17 municipalities that fared poorly on each of the

1 This value was transformed to a logarithm base 10.

2 This value was transformed to a logarithm base 10.

3 See <http://mfma.treasury.gov.za>

subcomponents and obtained scores below 0.37.

Diagram 1 below illustrates the *PI* scores for each of these four groups.

Trend 1: Only eleven municipalities fall into group 1. Members of this group have a compliance index of greater than 0.85. These municipalities obtain high scores on all three variables (repairs and maintenance, debt level and management cost growth). Given this there is limited room for members of this group to improve performance.

Trend 2: With 169 members more than half of all municipalities fall into this group. All metros are also members. Within the group there is a moderate rate of decline in overall scores indicating that incrementally improving performance on each of the three measures is a viable strategy for improving performance. This strategy hinges on municipalities progressively reducing the debtors' book, increasing expenditure on repairing and maintaining PPE and limiting the difference in the growth of own revenue and management cost. The trend for this group is illustrated on the graphic by the flatter projection line.

Trend 3: This is the second largest group of municipalities with 81 members. Each obtains a score between 0.37 and 0.59. The rate of deterioration within this group is more marked than in group two. Whereas municipalities in group two tend to score moderately well on each variable members of this group tend to perform noticeably poorly on at least one of the variables. This suggests that members of the group need to pursue the strategy of incremental improvement (as does group two) and have targeted interventions in those fields where they performed particularly poorly. The trend within this group is shown by the steeper dashed line.

Trend 4: The fourth group is a small group of 17 municipalities that fare poorly on all of the three variables. They thus have high debt levels, do not maintain existing assets adequately and have a salary bill for management that rises faster than municipal own income. The defining feature of these municipalities is the prominence of a "moral hazard" where political officers and senior management receive increased benefits despite deteriorating municipal sustainability. External intervention is thus warranted – if for no other reason than establishing dis-incentives for poor performance.⁴ As a group, a rapid rate of deterioration is clear.

Overall, there is a poor correlation between municipal performance and the likelihood of s 139

While almost one quarter of the Trend 4 municipalities has been subject to a s139 intervention there is, overall, a poor correlation between municipal performance and the likelihood of s139 interventions. The other three tracks (including Track 1) were all equally likely to have been subject to a s139. As the interventions in Track 4 municipalities can be accounted for by shortcomings elsewhere (like repeated audit disclaimers) poor performance does not appear to be a primary consideration for

4 If municipalities were unable to provide estimates of a key variable for at least one of the years under review they were accorded a 0 value for that sub-index. This was particularly pronounced with respect to the value of PPE and the amount of money spent on repairs and maintenance. The fourth group thus includes several municipalities where performance levels have not been measured at any time and thus are unable to reach benchmarks and conform to regulations.

provinces choosing to intervene in municipalities.

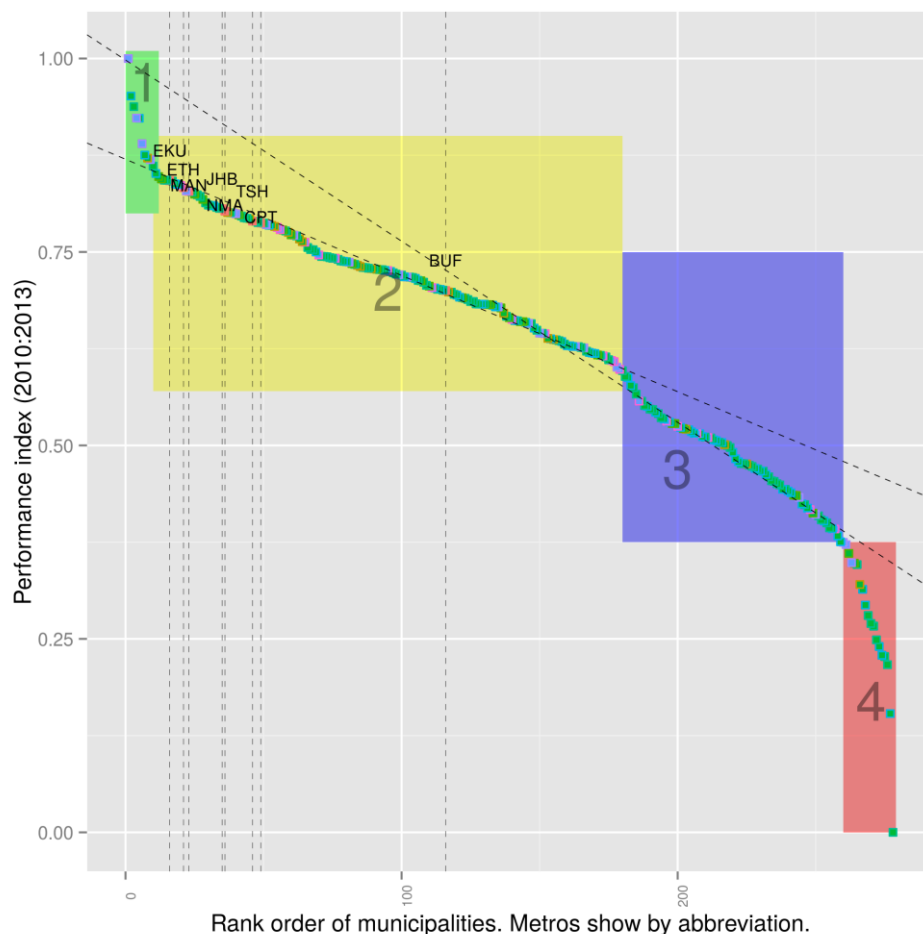
Generally, larger municipalities tend to have better levels of performance

All the metros fall into group two and each metro received a *PI* score that was significantly better than the national average. The average *PI* score for category A (metros) was 0.8, B1's scored an average of 0.76 and municipalities that were not centred on a city scored an average *PI* of only 0.65. However category C municipalities (District Councils) with smaller staff compliments and lower service responsibilities scored well.

Although bigger municipalities tend to perform better the relationship between municipal size and *PI* rating is loose. Several small municipalities fare very well on the *PI* score and some large (non-metro) municipalities score very poorly. It is clear that there is no causal relationship between municipal size and the *PI* rating.

The location of each metropolitan municipality on the *PI* spectrum is highlighted on diagram 1 below. This diagram shows the distribution of *PI* scores for all local, metropolitan and district municipalities.

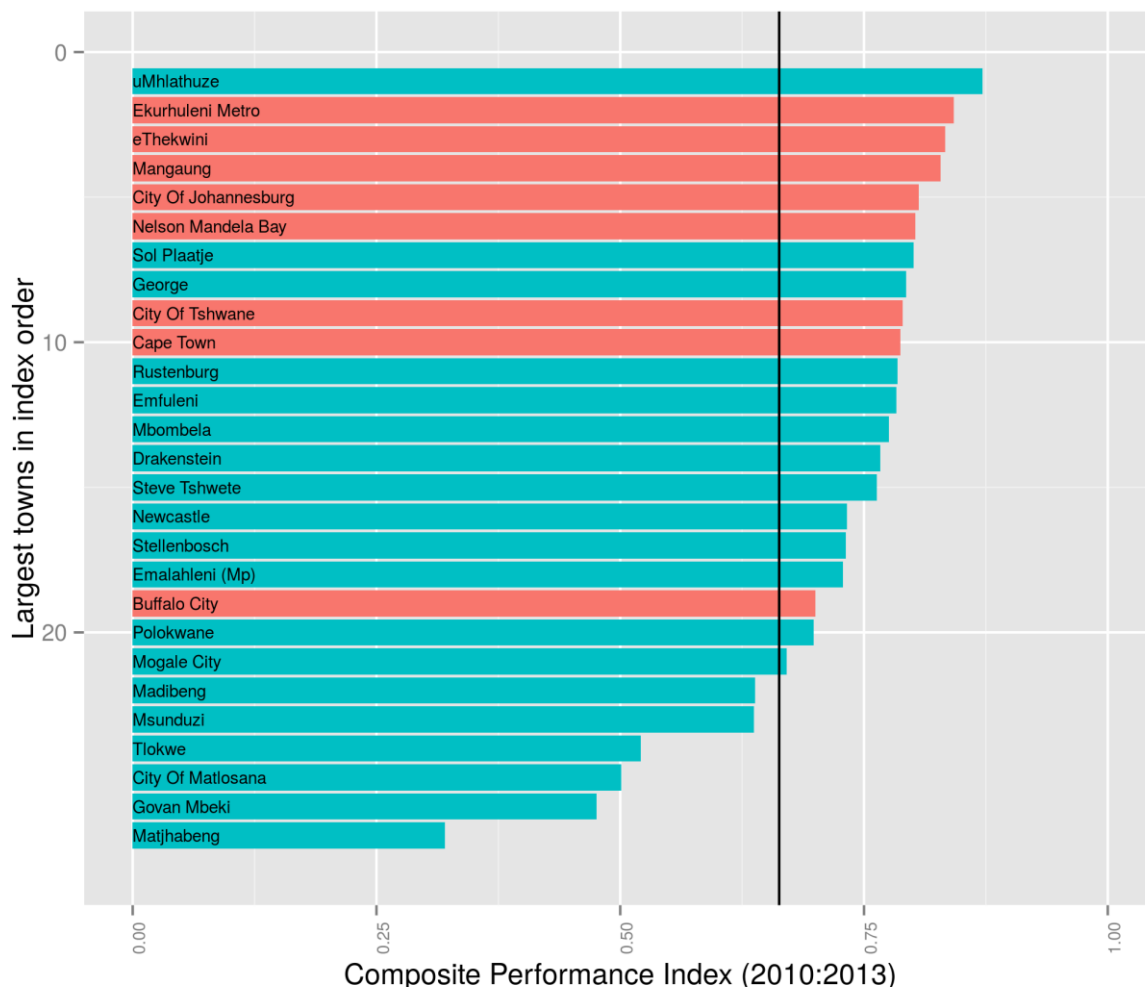
Diagram 1: Performance of all municipalities



All but six cities (and all metros) perform at levels that exceed the national average

There are 27 category “A” and “B1” municipalities. The 27 include all of the country’s large cities and these are the focus of the Capable Cities Index. In 2012/13 these 27 municipalities accounted for approximately 75 percent of the budgeted operating expenditure of all municipalities. Diagram 2 below shows how the cities are distributed on the *PI* index illustrated above. All but six cities (and all metros) perform at levels that exceed the national average. The national average of 0.7 is shown by the vertical line on diagram 2. With few exceptions the metropolitan municipalities tend to dominate the upper end of the scale.

Diagram 2: Performance of cities



There is a geographic dimension to *PI*. Most of the cities with a *PI* below the national average are from the North West Province.

The performance of municipalities with respect to the three specific measures of the *PI*

As described above the *PI* uses three specific measures namely:

1. Repairs and maintenance.
2. Debt level
3. Management cost growth

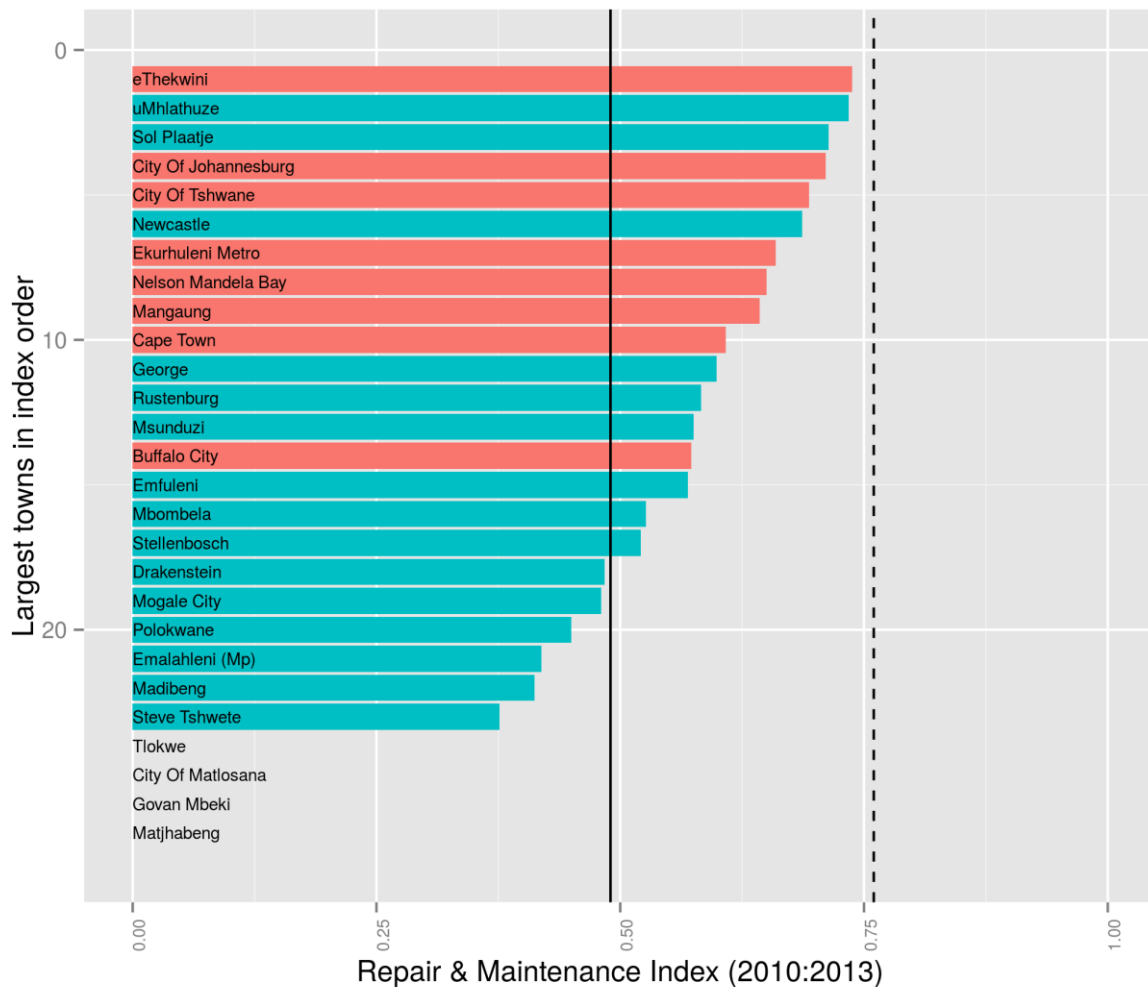
With respect to these measures, the *PI* indicates that:

No city reaches the prescribed spending level with respect to repairs and maintenance of assets

The first sub-component of the *PI*, repairs and maintenance measure, is a measure of what proportion of asset value is spent in maintaining those assets. As highlighted above, the National Treasury sets a benchmark of at least eight percent of the value of Property, Plant and Equipment (PPE) being spent on maintaining those assets. Failure to do so indicates that the assets will function at sub-optimal levels and will need to be replaced unnecessarily early. Few municipalities attain this level for any length of time.

Across all municipalities an average of only 4.1 percent of PPE is currently spent on repairs and maintenance. This is half the benchmarked value and corresponds to an index value of 0.49. This is indicated by the solid vertical line on diagram 3 below. The benchmark set by Treasury is indicated by the dashed vertical line.

Diagram 3: Performance of municipalities with respect to repairs and maintenance of assets



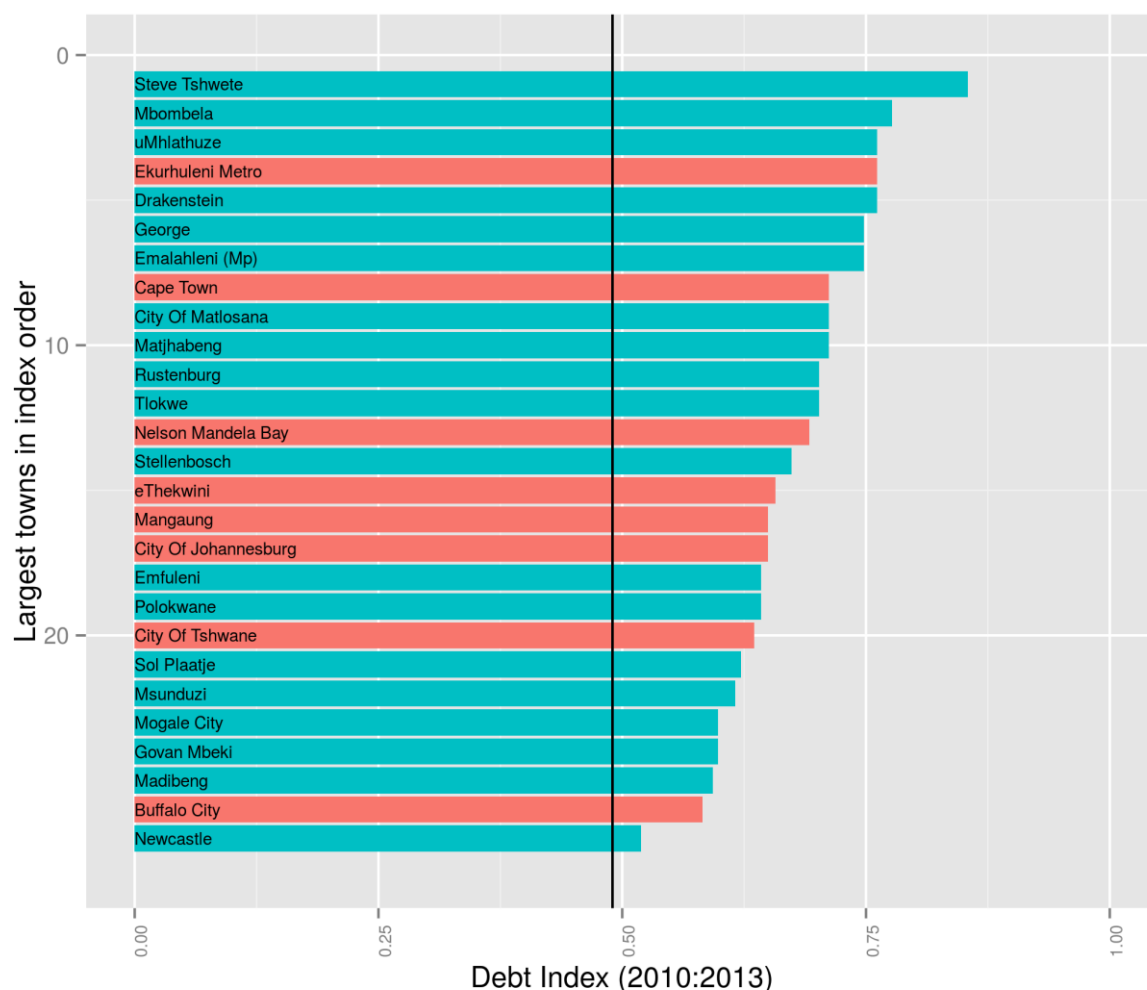
While most (17) of the 27 cities attain a *repair & maintenance Index* score that is above the national average no city actually reaches the prescribed level. Four of the cities have been unable to provide estimates of the value of PPE and their expenditure on repairs and maintenance for any of the years reviewed. These have been allocated a value of zero on this component of the index.

An average of 24 percent of services billed for by all municipalities had not been paid for within the prescribed time

This part of the index measures the extent to which the municipality receive timeous payment for services rendered. As various grants like the equitable share allocation are intended to cover the costs of providing basic services to the indigent the value of these services are excluded from the index.

For the period under review an average of 24 percent of services billed for by all municipalities had not been paid for within the prescribed time. This level corresponds to an index score of 0.49. All cities obtain a debtor index score that was above this national average, as reflected by the continuous black vertical line on diagram 4 below. The distribution implies that cities are significantly better than smaller municipalities at being paid for services rendered.

Diagram 4: Performance of municipalities with respect to debt collection

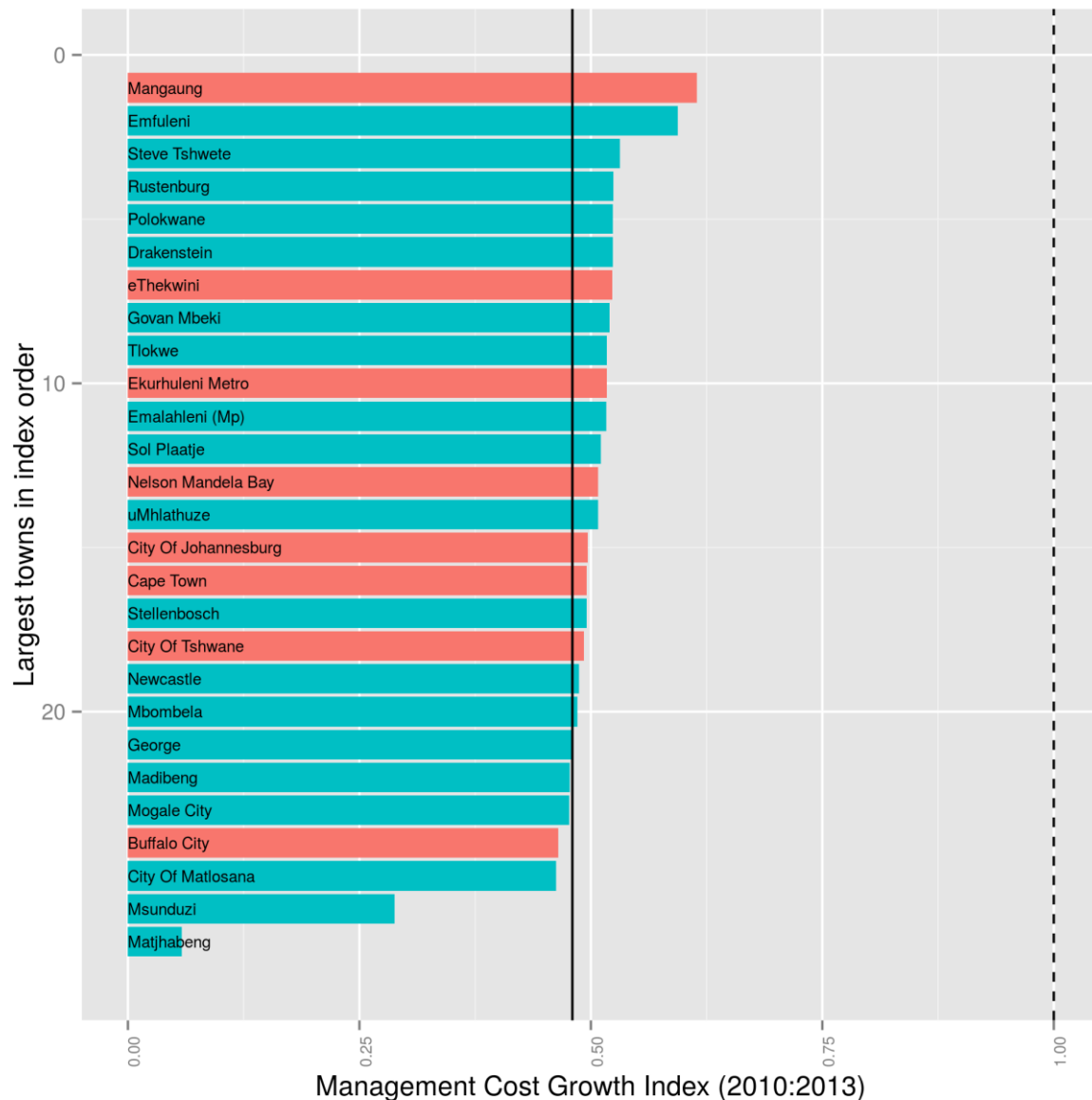


The salary bill for political officers and senior management grows 4 percent faster in each year than municipal revenue does

Political officers and senior management constitute a significant cost to municipalities. In 2013/14 this bill for the management came to 27 percent of municipal own revenue. As a rule the cost for the management tends to be higher for small municipalities – particularly when size is measured in financial terms. In order to avoid the bias against small municipalities which is inherent in the measures like the “proportion of revenue spent on salaries” this index is based on the growth in the salary bill relative to the growth of municipal revenue.

Currently the salary bill for political officers and senior management grows 4 percent faster (each year) than municipal revenue does. To the extent the salary bill consistently exceeds the benefits of employing the management a moral hazard exists in remuneration practices. This in turn undermines the financial sustainability of municipalities.

Diagram 5: Growth of management cost relative to revenue growth



There should, at the very least, be a general equilibrium between revenue growth and the salary bill – each percentage point growth in salaries should result in a commensurate increase in revenue. This situation, which approximates a *management cost growth index* value of 1, is represented by the dashed vertical line on diagram 5 above. Clearly cities are well off the mark in this regard. The national average for all municipalities corresponds to 0.48 (shown by the solid line).

All but four cities perform better than the national average on the *management cost growth Index*. This implies that salary inflation is significantly more pronounced in smaller municipalities.

