

UTILITIES: BALANCING REGULATION AND THE BOTTOM LINE



“The way utilities companies prepare for and react to their respective regulatory reviews for the new five-year regulatory cycle, which begins next year, will have a profound impact on their businesses. The expected challenge is countered by the opportunity to unlock potentially around £1 billion across the sector through greater efficiency.” Terry Povall - Head of Utilities

The industry is subject to tight policing from regulatory bodies such as Ofwat and Ofgem. Part of the regulators’ remit is to set financial determinations every five years to improve the services to water, electrical, gas and telecoms customers. Regulatory periods for both power and water are due to commence in 2010.

Forthcoming determinations

The forthcoming determinations are likely to be demanding, with a stricter customer-pricing structure resulting in the need to deliver more for less from operational and capital expenditure. However, comparison across the performance of utility companies in the UK shows a dramatic difference between the best and worst. Identifying and implementing industry best practice could unleash efficiencies to a value of around £1 billion, whilst helping companies meet the new requirements. Naturally enough, the key question being

asked by owners and investors is, ‘how to balance priorities while maximising the performance of our business?’

While on the surface, the tens of billions of pounds investment submitted to Ofwat and Ofgem sounds promising, it needs to be seen in the broader context of complex and often varying priorities.

Regulators’ expectations

The regulators’ expectations are high: they will insist on cost reductions as well as improved performance; strategic investment to meet user demand as well as technological innovation. The increasingly vocal environmental bodies will need to be reassured that their concerns are being fully addressed. The issue of global fuel poverty is, for example, another area that needs serious attention - as resources become scarce, the security of energy will become a huge worldwide concern. Water leakage levels will become even more of a problem as natural water levels worsen due to global warming. Current rainfall levels in some areas of the UK are already at an all time low which may jeopardise future supply security. The boardroom challenge is to balance these priorities in setting their new business plans.



Investor and owner priorities

There are also the investor and owner priorities. Several of the major UK companies are now owned by European parent companies that are focusing on growing their non-UK businesses, particularly in emerging markets with competing demands on their capital. Another issue for utility company boards is dealing with staff expectations in the context of the scarcity of skills, e.g. linesman in electrical distribution. This adds to the challenge of balancing priorities.

Clearly we're dealing with colossal infrastructure here and a complex landscape that's in a constant state of flux. No one has a holy-grail model, particularly as constraints and imperatives change every five years when the new determinations are introduced. Companies must find a way to read the evolving market to determine what works elsewhere and what doesn't.

Maximising returns

Experience and objectivity are key factors in uncovering best-practice alternatives, benchmarking a company's performance against others, and assessing performance challenges. As well as maximising returns from built assets, clients need to analyse their operational processes. Focused organisational design and OPEX and CAPEX efficiencies can help utilities companies realise their full potential.

We've witnessed this first hand in our many partnerships with utilities companies, saving millions of pounds in overheads, helping one in particular to achieve 14% improved efficiencies. As a rule of thumb, we anticipate being able to deliver a minimum of 3 to 7% return on contract spend, which has a direct effect on shareholder return and also supports strategic investment but critically delivers a better value result for the customer.

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