

Sustainable funding of the water industry?

Marketforce and Adam
Smith Institute - Future
of Utilities conference

A presentation given by

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Marketforce and Adam Smith Institute
Future of Utilities Conference
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Our experience is that the separation has created value and pays back in five years.....

		PV of cash spent & savings already realised	PV of all costs & savings if no further efficiencies	PV of all costs & savings with dynamic efficiency
Set up costs	<ul style="list-style-type: none"> The Commission spent £5.7m (funded by grant). The Scottish Water Group spent £13.6m. This was capitalised*. CMA set up costs were £3.2m. 	-£22m	-£22m	-£22m
Ongoing costs	<ul style="list-style-type: none"> Regulator's levy of £1.2m. CMA costs of £2.5m. Extra cost of capital of £0.7m. 	-£9m	-£119m	-£119m
Current savings achieved	<ul style="list-style-type: none"> Assuming Business Stream would have improved at the same rate as Scottish Water since 2006-07, it has further reduced costs by £8.1m per year. No savings achieved by Scottish Water have been included. 	+£18m	+£279m	+£279m
Savings from dynamic efficiency	<ul style="list-style-type: none"> Incremental retail efficiencies (1% per year) Incremental wholesale efficiencies (0.05% per year) 			+£85m +£110m
	NPV	-£13m	+£138m	+£333m

Separating retail and wholesale in England and Wales is likely to deliver even more benefits.....

Set up costs

- Assume conservatively that companies south of the border incur same costs per non-household customer:
 - No allowance for codes already working; and
 - No allowance for experience already earned.
- Assume CMA to be fit for purpose for pan-GB market: £10 million new expenditure
- Assume Ofwat costs to implement framework: £8 million new expenditure

Ongoing costs

- Assume CMA operating costs increase to £10m per year – a £7.5m increment.
- Assume extra costs for Ofwat of £2m a year.
- Assume extra costs of capital allowance of £6m a year.

Ongoing cost reductions

- Assume no mergers.
- Assume on average companies achieve only 2/3rds of the savings achieved by Business Stream.

Dynamic efficiency

- Incremental retail efficiencies (1% per year)
- Incremental wholesale efficiencies (0.05% per year)

Present Value of all costs and savings without dynamic efficiency

Present Value of all costs and savings with dynamic efficiency

-£182m

-£182m

-£529m

-£529m

+£1479m

+£1479m

+£734m

+£988m

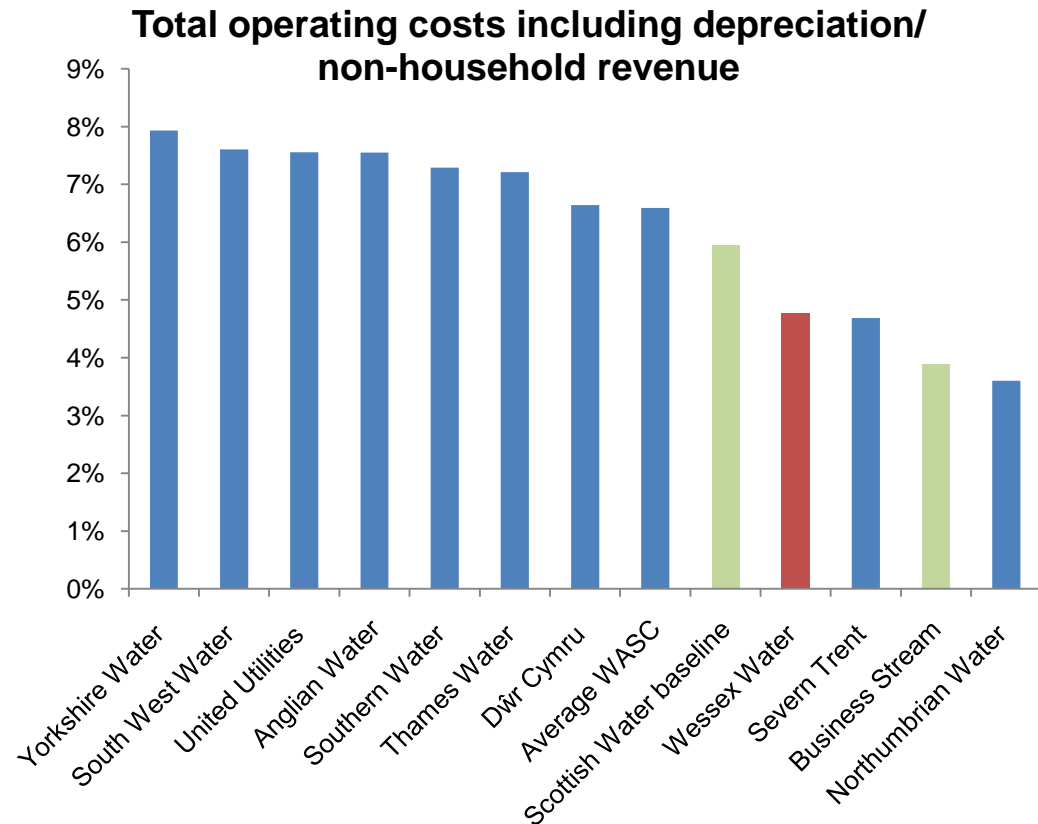
NPV

+£768m

+£2.5bn

Actually separation does not need to lead to losses in economies of scope and it boosts efficiency- Wessex and Scottish Water stand out....

- Wessex and Bristol Water established a customer services joint venture company some ten years ago.
- Glas Cymru tendered its retail services separately from operations.
- United Utilities established Vertex to handle its customer services, and have subsequently moved away from this model.
- Many other water and sewerage companies have chosen to out-source elements of retail activities, such as call centres, meter reading and billing.



source: OFWAT June Return 2010, table 21b and table 23

Our statutory duty was to do no 'detriment' to the core (wholesale) business of Scottish Water.

- We did not sub-divide the RCV;
- We allowed for the same WACC as before the separation;
- We require the licensed providers to pre-pay the wholesale charges due to Scottish Water;
- We allowed for an additional return to be earned by the retail business;
- We allowed for the additional costs of the new market framework, but offset these with an additional efficiency challenge;
- No new investment capital was required;
- Set-up costs were capitalised, allowing a return to be earned.
- Business Stream stays part of the Scottish Water Group for as long as its owners decide this to be appropriate.

Find out more at:

www.watercommission.co.uk

www.scotlandontap.gov.uk

