

# Sustainable funding of the water industry?

Marketforce and Adam  
Smith Institute - Future  
of Utilities conference

A presentation given by

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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
<b>Set up costs</b>	<ul style="list-style-type: none"> <li>The Commission spent £5.7m (funded by grant).</li> <li>The Scottish Water Group spent £13.6m. This was capitalised*.</li> <li>CMA set up costs were £3.2m.</li> </ul>	-£22m	-£22m	-£22m
<b>Ongoing costs</b>	<ul style="list-style-type: none"> <li>Regulator's levy of £1.2m.</li> <li>CMA costs of £2.5m.</li> <li>Extra cost of capital of £0.7m.</li> </ul>	-£9m	-£119m	-£119m
<b>Current savings achieved</b>	<ul style="list-style-type: none"> <li>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.</li> <li>No savings achieved by Scottish Water have been included.</li> </ul>	+£18m	+£279m	+£279m
<b>Savings from dynamic efficiency</b>	<ul style="list-style-type: none"> <li>Incremental retail efficiencies (1% per year)</li> <li>Incremental wholesale efficiencies (0.05% per year)</li> </ul>			+£85m +£110m
	<b>NPV</b>	-£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

Present Value of all costs and savings without dynamic efficiency

Present Value of all costs and savings with dynamic efficiency

-£182m

-£182m

## 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.

-£529m

-£529m

## Ongoing cost reductions

- Assume no mergers.
- Assume on average companies achieve only 2/3<sup>rd</sup>s of the savings achieved by Business Stream.

+£1479m

+£1479m

## Dynamic efficiency

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

+£734m

+£988m

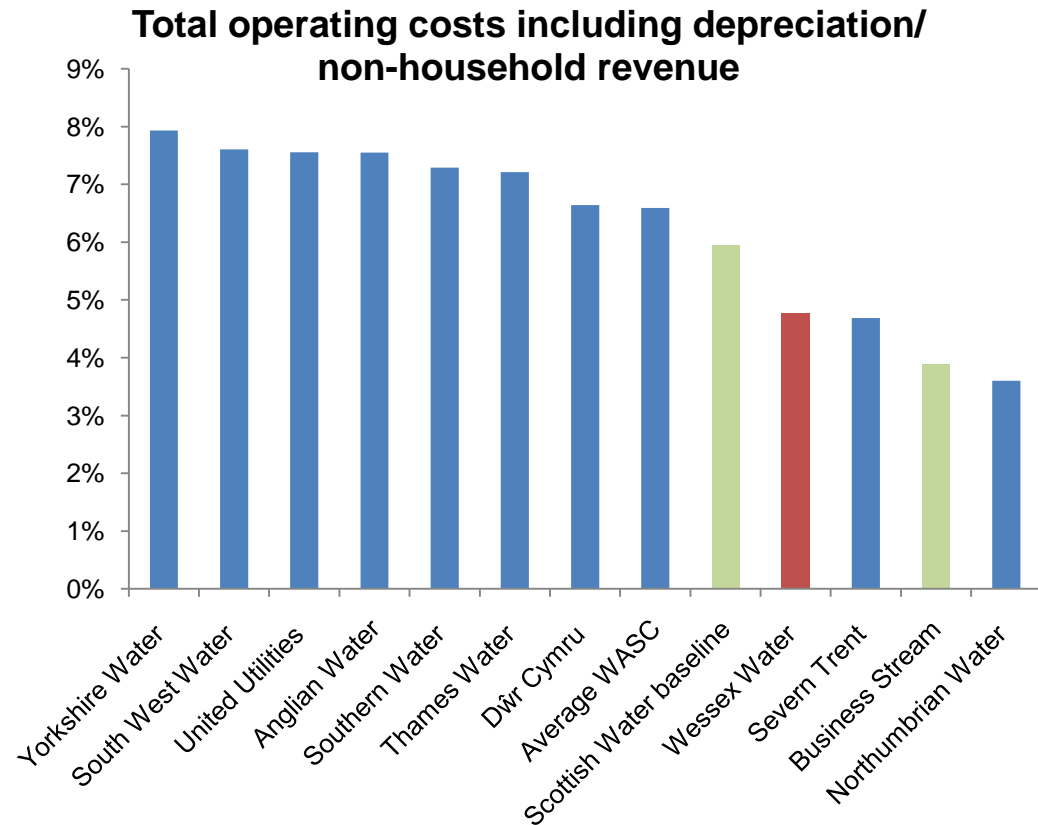
NPV

+£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](http://www.watercommission.co.uk)

[www.scotlandontap.gov.uk](http://www.scotlandontap.gov.uk)

