

SCOTTISH WATER MERGER AND OUR EXPERIENCE

WAREG and Florence School of Regulation: Water Services Aggregation

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Chief Executive

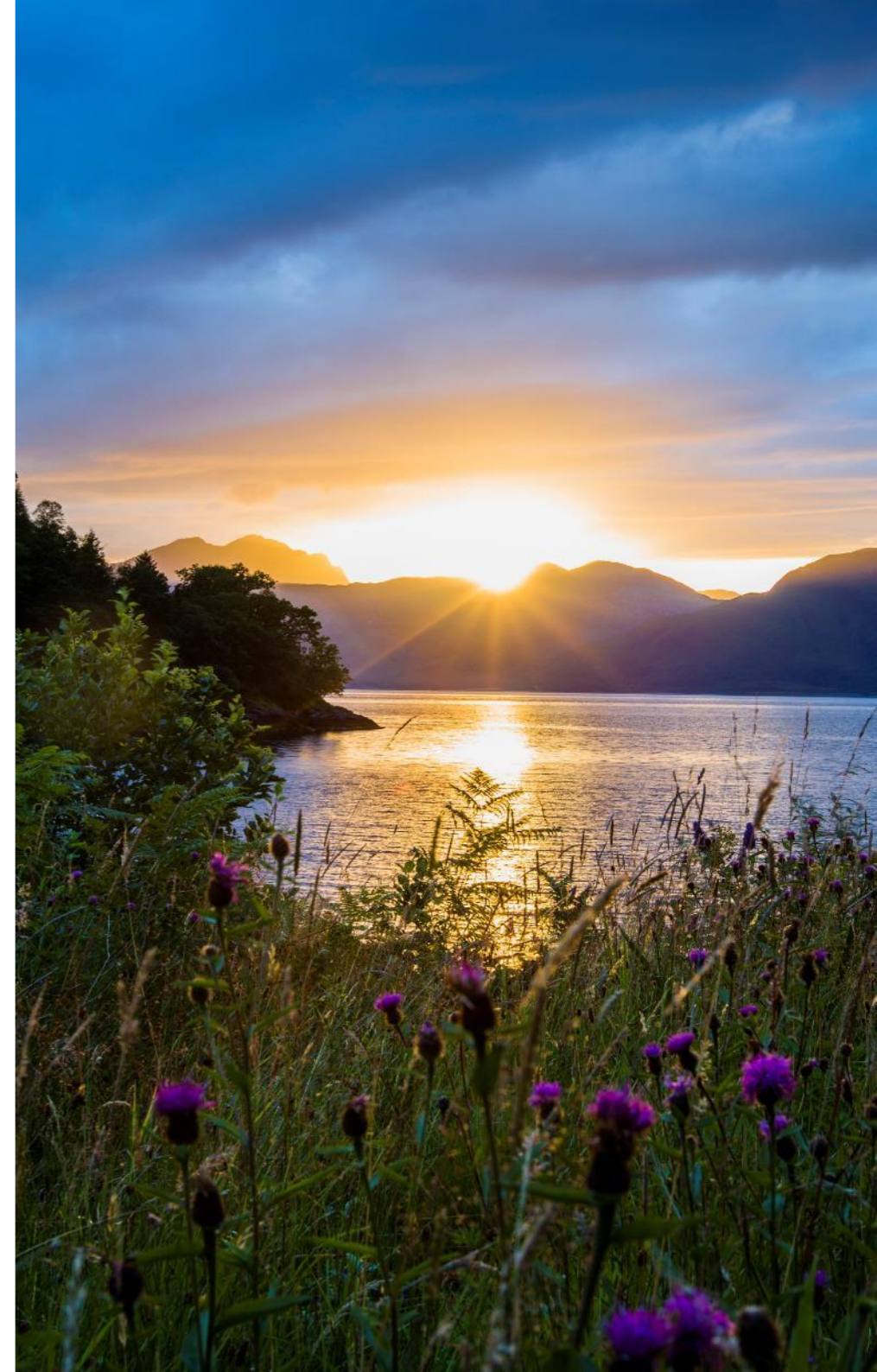
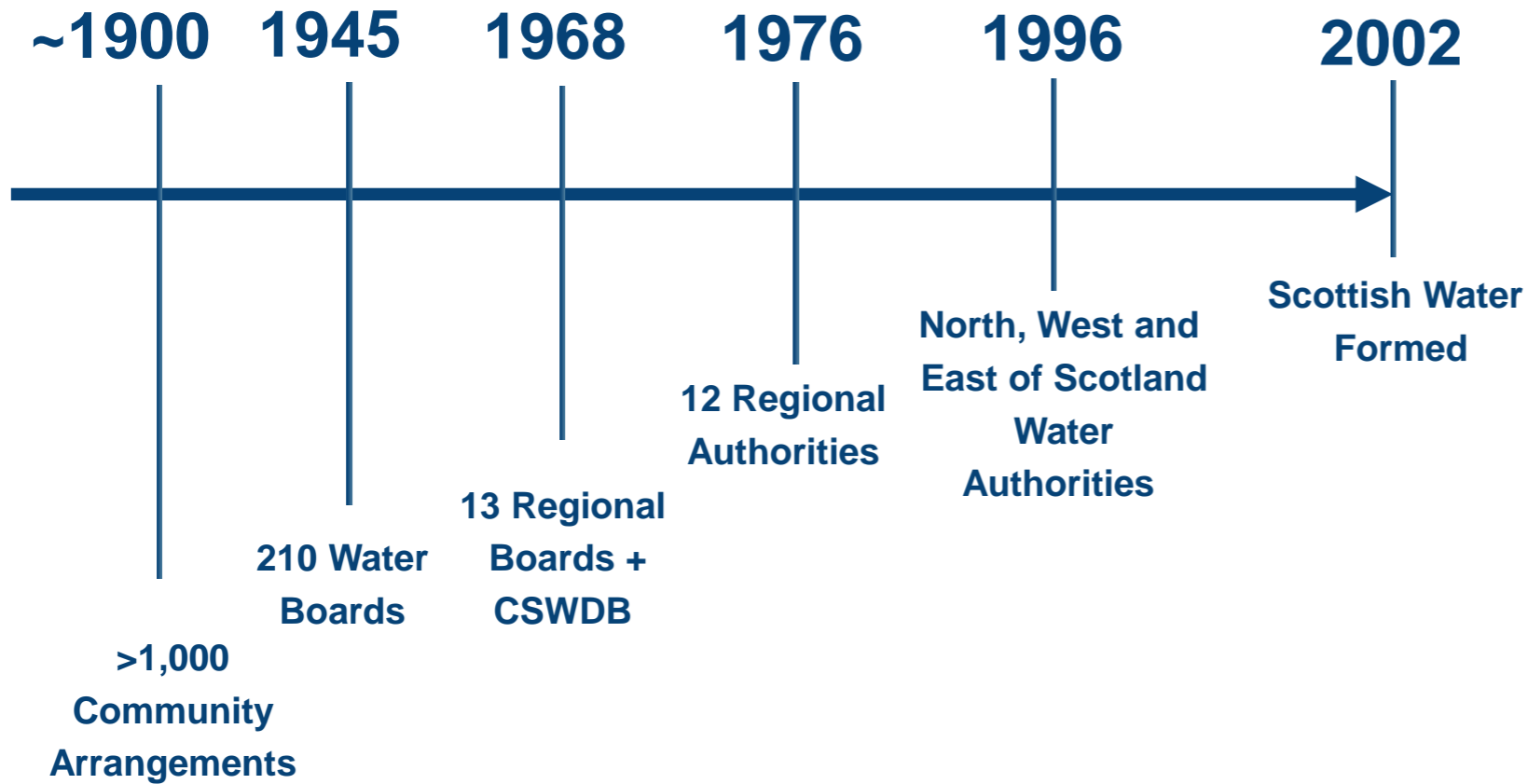
15 September 2021



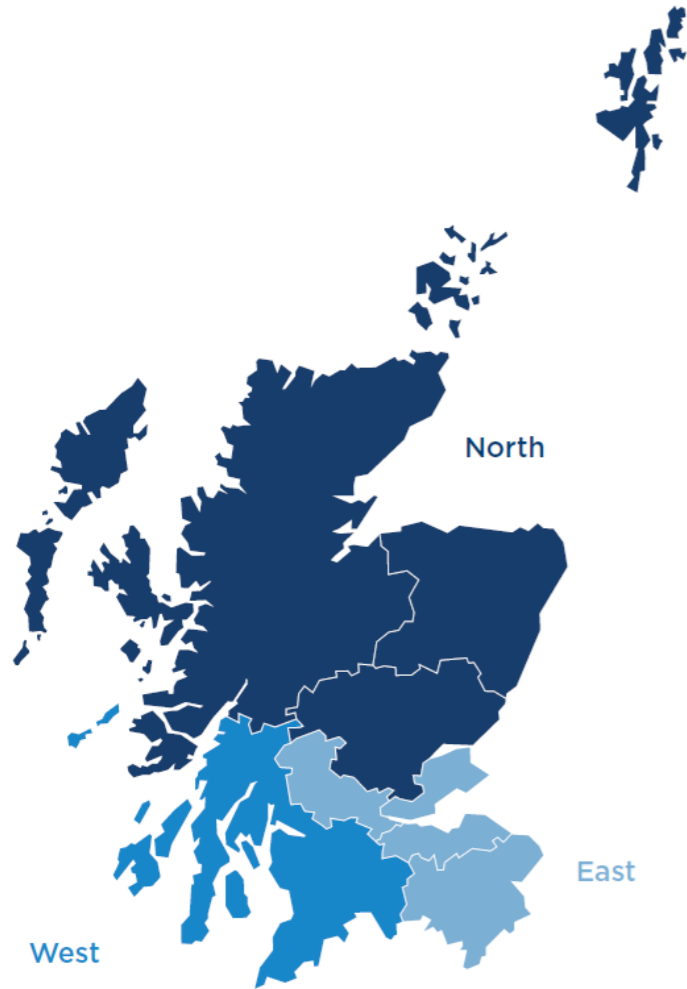
WHAT HAS THE MERGER JOURNEY BEEN?



The water industry in Scotland has come a long way...



Focusing on the creation of Scottish Water in 2002...



- Investment lagged behind England and Wales
- The Scottish industry lagged far behind in service levels and, in many cases, had only a limited understanding of how its operations were affecting customers.
- Its relative operating costs and unit capital expenditure efficiency were very poor relative to the industry in England.
- Charges in the more rural north of Scotland were going to be at least double those in the more populous East and West.

WHAT MADE THE DIFFERENCE SECOND TIME AROUND?



There were three principal differences...

- The Governance of Scottish Water
 - There is clear policy direction given to a competence based Board.
 - The management is chosen for its expertise.
- The regulatory framework is effective
- The single entity avoids acute regional trade offs having to be made
 - Scottish Water charges the same price to all customers in a particular class;
 - Levels of service are consistent wherever a customer is located

Turning to the role of economic regulation...

- **Hard budget constraint**
 - Makes the regulated company a price taker and creates a pressure to improve its financial performance
- **Information collection and analysis**
 - Reducing the inevitable asymmetry of information between the regulated entity and its regulator;
 - Enables econometric and unit cost benchmarking; and
 - League tables.

WHAT COULD HAVE GONE BETTER?



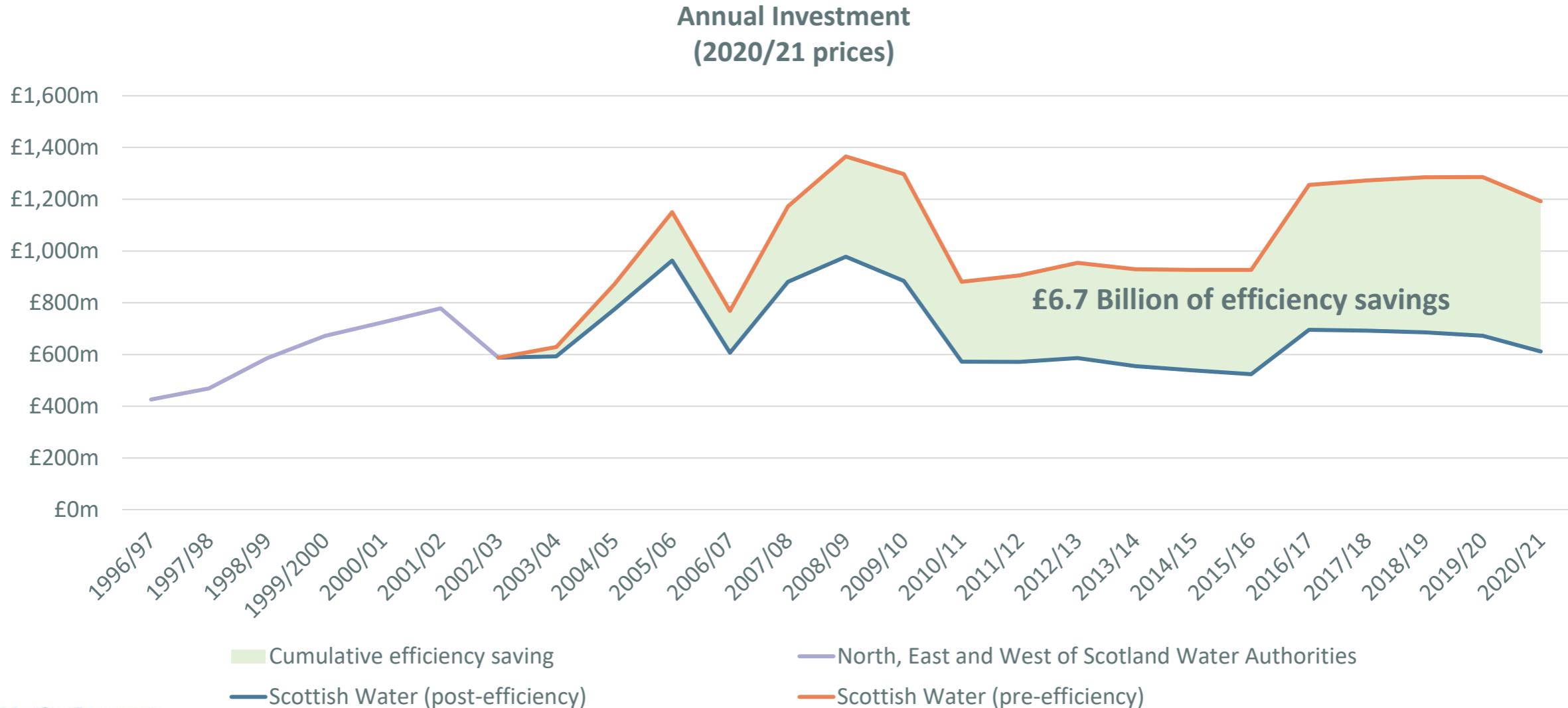
There are two obvious areas...

- **Harmonising charges is difficult!**
 - There can be incidence effects both within individual regulated entities and between entities.
 - Such effects can be very toxic politically – and difficult to understand. There are no short-cuts!
- **Borrowing is a source of financing not funding – Be aware of unintended consequences!**
 - Borrowing is appropriate to assist in phasing transition in charges of investment
 - Or to accommodate larger one-off projects...

WHAT BENEFITS HAVE BEEN DELIVERED?

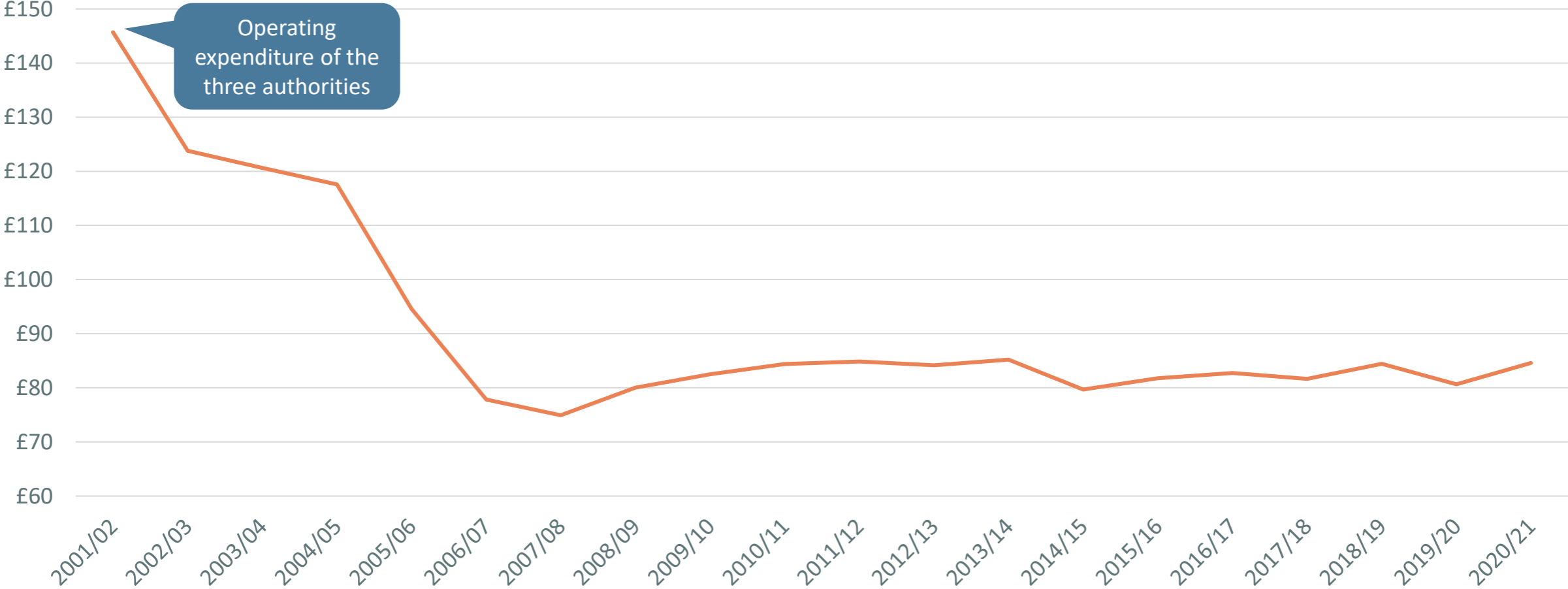


The merger led more investment – which was delivered more efficiently...



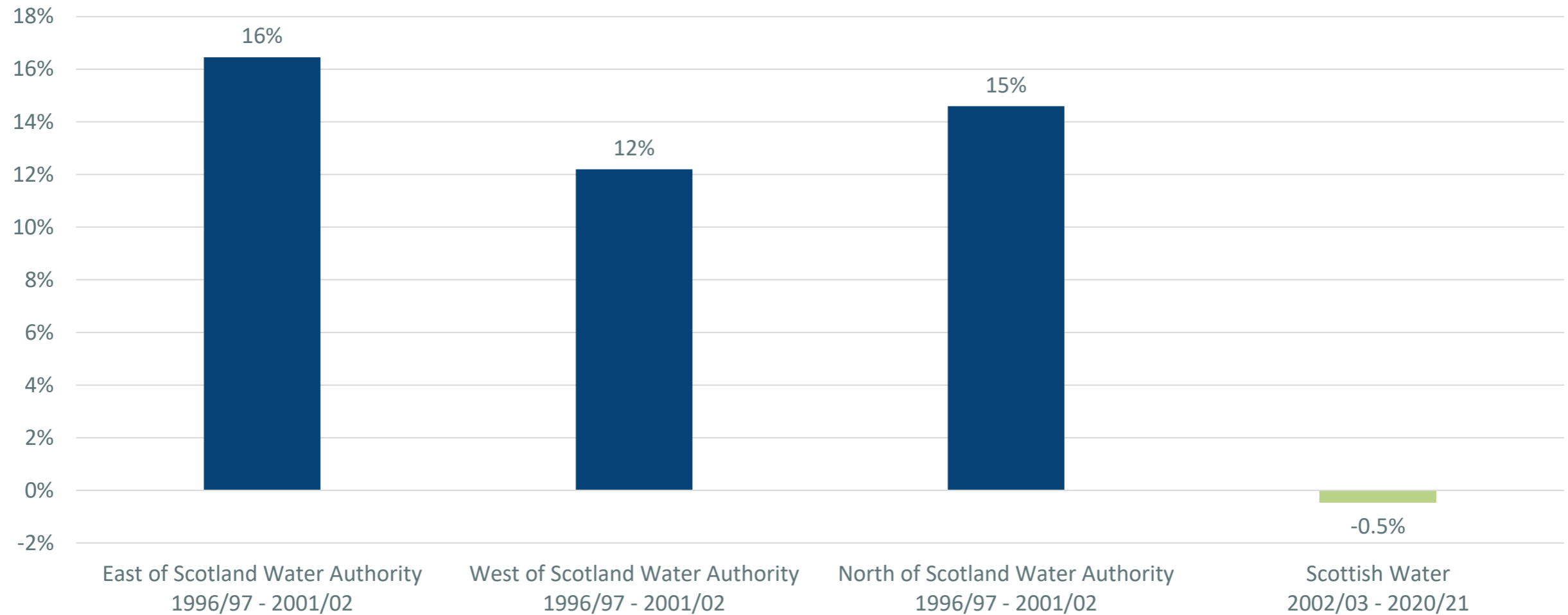
Operating expenditure has reduced by over 40%...

Operating expenditure per connected citizen
(2020/21 prices)



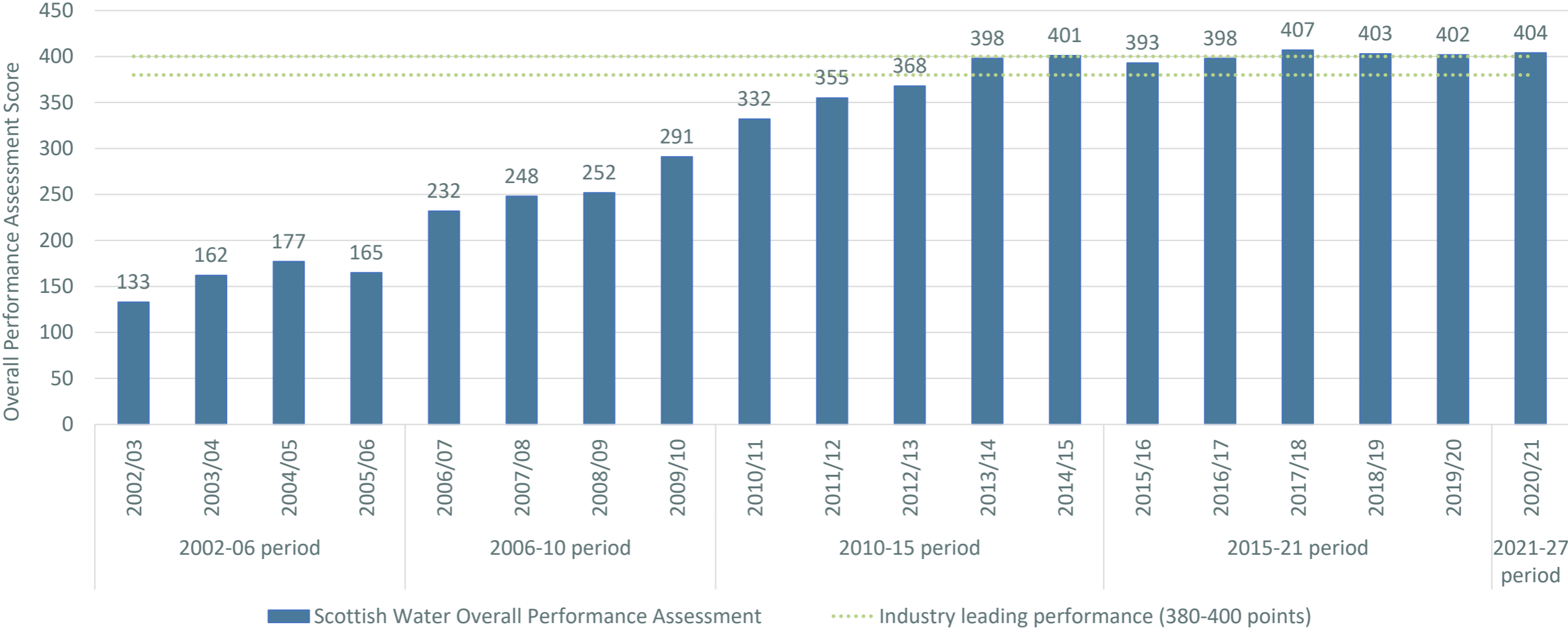
These efficiencies have allowed customers to enjoy a real reduction in household bills since the merger...

Annual average price change (real terms)



Scottish Water now matches industry leading performance...

Levels of service (2002/03 - 2020/21)



Looking to the future...

- These reforms mean that Scottish Water is better placed to meet the challenges ahead – most notably, achieving net zero emissions by 2040 on both operational and embodied carbon.
- The nature of the regulatory and broader stakeholder relationships has changed – there is a joint vision and purpose. But Scottish Water is clear that falling short will have consequences...

THANK YOU

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WICS Economic
regulation for
Scotland's water

