

6 INDUSTRY COMMENT

POLL POSITIONS: MARKET OPENING AND POLITICAL RISK

Water companies are preparing for the biggest change to the water industry in England since privatisation: the introduction in 2017 of non-household retail competition. Some are showing enthusiasm for the new opportunities while others are not keen to invest in a market which is very different from their core regulated market. One of the most important and difficult areas to prepare for is any change to the legislative and regulatory framework for competition.

Electricity Market Reform (EMR) shows that over an extended implementation period, political changes and technological developments will almost certainly result in significant policy changes which companies have to comply with. With an election in six months and more than two years until market opening, there is time for policy changes. This is a concern, particularly as the Labour Party is proposing commercially significant

changes if elected.

However companies cannot wait for policy certainty and need to be refining their strategy and preparing for the competitive market now. The winners so far from EMR are renewable energy developers who bid successfully for early subsidies for large projects before the limited subsidy budget was used up.

General election

The urgent political risk is general election manifesto commitments which could significantly distort or delay the new market. Policy changes could render some of the time and money already invested in preparing for the competitive market abortive; or could tie the market up in red tape so that even efficient and effective companies cannot thrive and customers' needs do not drive the market.

While manifestos are not expected until April 2015, the par-

ties have been working on their policies (see box). Note: policies can change if that is politically advantageous. The party with the starkest proposals for policy change is Labour which intends to address the issue of affordability. A potential flash point for water affordability issues is the Thames Tideway which Thames Water says could increase water bills by £80 pounds a year in a worst case scenario.

So what should companies do now? Given the real risk of policy change, water companies need to be agile but they also need to start preparing for competition before there is complete clarity on the design of the new market. Companies have to quickly develop the right strategies, corporate culture and pricing. Key pressing steps include:

- Staying close to political developments and working with government on policy to avoid unintended consequences.
- Developing and testing a robust regulatory and commercial strategy which balances sustainability, political acceptability and regulatory compliance with appropriate risk adjusted returns. This will be challenging and is likely to require a number of iterations and significant input from the board and shareholders.
- Working to understand the dynamics of a competitive market and their positioning within it. Experience in the competitive Scottish market and in other similar markets can provide insights into the number of major players the market can sustain, what generic



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strategies (being a low cost producer, product innovator, or high service provider, etc.) are most likely to be successful, the prospects for growing market share and the level of investment required.

■ Building the structure and culture of the retail business, including appropriate separation from the wholesale business, so that it can grow profitably. At present many water companies are focussed on engineering, financial and regulatory issues. Marketing and pricing a product in a competitive market is foreign and a radically different culture and customer experience will be required to be successful.

■ A fresh approach is needed to product development and pricing. In a competitive market companies will benefit from being fleet of foot and having the flexibility to tailor products to meet demand and to respond to competitors.

Companies have a great deal to do to be "market ready" in 2017 with a strategy which is commercially sound, complies with the market code and competition law, and is agile enough to respond dynamically to developments in the market. **TWR**

PARTY PIECES: CURRENT WATER THINKING

■ **Labour:** Will require greater social responsibility from the water companies, including compliance with a new compulsory national affordability scheme. Labour also proposes giving Ofwat increased powers to change water company licences to respond to changes in company structures and ownership, and "increasingly exploitative behaviour by some" water companies.

■ **Conservatives:** While they are naturally in favour of competition, their policy interventions in energy billing show they felt obliged to respond to Labour's popular promise to cut the cost of an essential utility. The Conservatives are likely to act if, following the introduction of competition, a significant number of small enterprises face material increases in charges and switching is limited.

■ **Liberal Democrats:** Are unlikely to propose major changes to the competitive market and they may not be effective in preventing policy change.