

## Case Study

### Building an unregulated Asset Management business for Anglian Water, Feb01 to Apr01

**Context** - By the end of the 1990s, UK water companies were finding it difficult to achieve the profits expected of them by their shareholders – prices were constrained by regulation, there was little scope for increasing demand, and all the ‘easy’ cost savings had already been made. So what else could they do?

Some of the smaller companies attempted to merge with others in order to achieve scale economies, but the regulator was against large-scale consolidation in the sector. Others (most notably United Utilities, Kelda, and Glas Cymru) were experimenting with changes in corporate structure and ownership in an effort to reduce their cost of debt. All companies were looking to outsourcing to reduce costs, and, several were working together to combine their procurement activities through (internet based) organisations such as selectusonline, Achilles, Eutelia, and Pantellos.

**Our Role** – in 2001, AWG tried a radically different approach - the creation of a new Asset Management business outside the regulatory framework. While joint procurement can lead to savings of perhaps 5% to 10% on O&M expenditure, it became clear that introducing best practice system design & planning, standardising O&M processes and equipment/materials and rationalising the supplier base had the potential to achieve far more. But utilities have been trying to align standards and working practice for years without great success – the AWG proposal was to ‘encourage’ common standards by buying multiple networks to enforce central planning and control, followed immediately by selling the regulated parts of the business to avoid regulatory concerns about consolidation of regulatory activities.

Our role was to test the original concept using our knowledge of similar markets and industries, to assess the likely value that AWG could realise through the new business, to identify potential targets for acquisition, and to develop robust regulatory arguments that AWG could use with OFFER, OFWAT and the competition authorities if called to defend its actions.

Based on a detailed analysis of the asset management and infrastructure sectors (electricity, gas, water, telecoms, railways), we calculated that the annual UK annual spend on distribution network infrastructure is over £15 billion, and the scope, and that the ideal first candidates for acquisition were the electricity distribution companies. We put AWG in touch with potential partner organisations (financial institutions in most cases) that would take on ownership of the networks, leaving AWG to manage (operate and maintain) the networks under contract.

We held initial discussions with OFWAT and OFFER to test the concept before introducing our client, and supported AWG in its further discussions over the next few months.

**Results** – AWG has recently restructured its UK water business into three separate activities: Asset Ownership, Asset Management, and Service Provision. AWG also took the opportunity to refinance the business, increasing gearing and reducing their cost of capital. As a result, funds were no longer available for acquisition of UK assets, and so our plans to acquire an electricity distribution business were sadly never realised.