

Preparing for
Asset Management Plan (AMP) 6

Doing **MORE** with Less

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UK water companies follow a well-defined; five-year Asset Management Plan (AMP) to ensure continuous improvement based on guidelines set by the regulator of the water and sewerage sector in England and Wales, OFWAT. Perhaps the most important action of OFWAT is to regulate the industry price limits, ensuring that investors get sufficient returns while customer interests are not compromised.

Digging Deeper: Six Dimensions of AMP6 Program and Impact

Capital Investment

In contrast to 2010-15 (AMP5), the capital investment limit for the period 2015-2020 (AMP6) has doubled to GBP 44.3 Billion. This is lower than the companies' projections of GBP 45.7 Billion, suggesting that the sector needs to enhance productivity and become more cost-efficient. The investments are likely to be utilized in tackling leakage, preventing supply interruptions and better managing sewage treatment and assets.

WNS's View:

Better Capex management through sharper focus on asset management, increasing efficiencies in delivery of projects, and supply chain management and well-structured metering rollout plan.

Improve customer experience through better efficiencies in leakage reduction, fewer floods and improved cash collection and debt management

Cost of Capital (for Wholesale Business)

Reflecting prevailing market conditions and low financing costs, OFWAT lowered the cost of capital from 4.5 percent in the previous period to 3.7 percent for 2015-20, with all players materially agreeing to the change. This will reduce allowed revenues (based on Investments, Capex + Opex) and profitability compared to the previous period. Customers will benefit to the tune of GBP 2 Billion by 2020 on account of the change while companies can save on financing costs by raising capital at rate less than 3.7 percent.

WNS's View:

Enhance revenue assurance capabilities across customer lifecycle encompassing order management, credit management, billing, remittance processing, collections and dispute management

Capital Incentive (Total Expense or Totex for Wholesale Business)

Since privatization, companies have been incentivized for Capex outperformance (i.e., lower amount spent vs. the limit set by OFWAT) through a capital incentive scheme. But from 2015 (AMP6), OFWAT is planning to reward companies based on Totex (Capex + Opex) in order to remove the perceived bias towards Capex. OFWAT has assumed a lower allowance than most companies requested, resulting in a Totex gap of ~ GBP 1.5 Billion. Most of this gap relates to just three companies.

In terms of operational performance, the regulator will also provide incentives to achieve higher (upper quartile vs. average) cost efficiency and customer satisfaction levels. For companies not in the upper quartile, OFWAT will provide a two-year window to reach the desired level and reward or penalize them.

WNS's View:

Create a scalable cost structure for G&A spending in areas such as Finance, HR, IT, Legal and Procurement

Retail Household Margins

To reward investors, the regulator has applied a 1 percent Net Margin for costs incurred on retail household customers. For 2015-20, household retail costs (basis for revenue identification) included in companies' business plans were GBP 4.1 Billion. However, OFWAT mandated reduction in retail household costs by GBP 0.9 Billion (based on draft determinations) through improvement in Average Cost to Serve (ACTS) efficiency and not automatically indexing retail price controls to the Retail Prices Index (RPI).

WNS's View:

Optimise costs in order entry, customer invoicing, cash application, deduction and claims management, dispute reconciliation, and increase adoption of self-service channels such as e-billing

Non-household Retail Margins

For non-household retail customers, OFWAT has fixed 2.5 percent Net Profit Margin on costs. The non-household retail costs proposed in companies' business plans for 2015-20 were around GBP 580 Million. OFWAT asked the utility players to lessen ~10 percent of costs, i.e., GBP 54 Million, suggesting a need for stricter cost discipline. In terms of promoting competition, AMP6 will also allow non-household customers in England to choose their retailer from April 1, 2017.

WNS's View:

Adopt new technologies such as Customer Interaction Services (CIS) platforms to foster customer loyalty and boost operational efficiency

Price Limit

OFWAT sets the tariffs based on the 'RPI+K' formula - which adds together the retail price index and the investment and profit ratio (K). K comprises operating expenses, investments, depreciation costs and return on capital and tax.

For water and sewerage companies, national average bill is likely to fall by ~5 percent (excluding the effect of inflation) from GBP 396 in 2014-15 to GBP 376 in 2019-20. Water companies will face more pressure with their bills declining by ~9 percent during the aforementioned period. These price limits are, on an average, 4 percent lower than that proposed in companies' original business plans. Customers are likely to benefit by GBP 3 Billion owing to price reduction.

WNS's View:

Control wholesale costs related to maintaining and developing the network and other assets

Improve Opex efficiency through reduced G&A expenses

Enhance customer service to earn incentives

Companies can use an integrated Meter-to-Cash

All this means that companies are gearing up for the biggest efficiency challenge since privatization since there will be

- a. Pressure on the revenue side with lower cost of capital, higher price limits, lower Totex and retail costs as proposed
- b. Cost of doing business, on the contrary, is likely to go up every year

In WNS's view, water and sewerage companies should undertake targeted programs focused on efficiency improvement and cost reduction while preserving or enhancing customer service levels.

Based on prior experience of working with other Utilities companies, WNS can align business process management and analytics capabilities more closely with sector specific business needs by

- ✓ Developing and implementing an integrated Meter-to-Cash revenue cycle management framework by combining CIS platform with various customer services including account management, billing and remittance, exceptions handling, collections and analytics-based services (debt analytics, fraud analytics, etc.)
- ✓ Managing shared services like accounting, customer care, collections, procurement, HR administration, legal services, etc.
- ✓ Designing programs via customer journey management to improve customer satisfaction and reduce cost-to-serve

Complexity in the water and sewerage sector in the United Kingdom

The water and sewerage sector in the United Kingdom varies widely by geography. Companies are owned, run and often subsidized by the government in Scotland and Northern Ireland, while the sector is completely privatized and largely regulated by a non-governmental body known as the Water Regulatory Authority (OFWAT) in England and Wales.

Adding to the complexity, Scotland and Northern Ireland have only one overseeing body, but differences in tariff. Water is reasonably priced in Scotland and completely subsidized in Northern Ireland. In England and Wales, OFWAT controls water tariffs and ensures that they remain reasonable for the customers while also allowing profit for providers.

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