Deciding now what we want to be tomorrow as a key way of speeding the water business change

R. Parena
Società Metropolitana Acque Torino Spa, Corso XI Febbraio 14, 10152 Torino, Italy, Chairman of the IWA Statistics & Economics Specialist Group (E-mail: renato.parena@smatorino.it)

Abstract Normally, in every industrial context strategic decisions design the business expected evolution. Fine tuned balances between customer needs and resources’ expected reward have to be pursued when economically evaluating how designed strategies impact on the Water Utilities’ competitive position. With such a purpose, strategies have to care for both the economic value produced for the stakeholders and the options and actions required. Evaluating dimensional strategies’ effectiveness in qualitative terms of market appraisal rather than in quantitative terms of growing bargaining power seems to be the best model to assess profitability and sustainability of designed strategies. Moreover, particular aspects affect the water business and need to be carefully considered when designing well-defined strategies aiming at speeding the required change. What efficiency is and then how to measure it is thus the major challenge for water managers.

Keywords Economic evaluation; profitable and sustainable strategies; stakeholders

Introduction

Everywhere and every time, water utilities’ Top Management has to solve high indeterminateness when approaching the economic evaluation of practicable future strategies speeding water business change that allow to decide now what to be tomorrow. Generally speaking on the one hand, making strategies often involves creativity and imagination but on the other hand granting economic stability in medium/long term requires rationality in calculations. It seems therefore that creativity and rationality have very small room to reconcile (UN, 2003).

Nevertheless, positive fine tuning has to be found in order to make both strategies more informed by rationality and calculations oriented by more economic rather than by strict accounting points of view. Beyond any doubt, the key point of a strategic decision is on how and how much it may impact on the company’s competitive position. Normally deep connections are established between strategic and investments decisions (OECD, 2000).

Keynote

It can be agreed indeed that the more an investment decision requires financial resources, the more it may be ticklish and not reversible. Similarly, it can be agreed that while several investment decisions have no real strategic value (e.g. conforming plants to new pollution or safety laws, automations, and so on), lots of strategic decisions may require very small or marginal new assets (e.g. advertising campaigns, organisational changes to enhance customer care and so on). So involving resources to gain future benefits really happens but the strategic value of the involvement exists only where remarkable impacts on the widely intended competitive position are derived.

The more the management is able to merge into an economically balanced context the customer needs satisfaction, on the one hand, and the resources’ expected reward, on the other hand, the more the business will be competitive.
Two facets can basically be identified when strategies come to be tuned to re-arrange
the basics of water business: “who” the business would be, or in other terms “which role”
the business would play in the economic system to which it belongs, and “how” the
business would operate to comply with its targeted identity. As for the first facet, strategy
is made clear by the economic value it will produce for its stakeholders and expressed by
its vision, mission, success key factors and culture. As for the second facet, strategy even
includes the practical options and actions the above address is requiring for: competitive
areas to operate, business units to implement, actions to be embarked on and so on.

All the stakeholders, among whom the shareholders gain a particular consideration
given the strict connection between the uncertainty of the business and the reward
they are expecting, strictly connect economic profitability of business with the ability
to satisfy their economic expectations. Current debate on public/private water utilities
management and existing investors owned water utilities make the above relevant for
the public services context at large providing interesting insight for discussion (OECD,
2000).

The above given, Top Management is therefore strongly required to define and adopt
strategies that suitably comply with the economic expectations of shareholders or, in
other terms, are able to “create economic value” for them. By such a point of view
“profit” has to be intended as an added wealth created by the business itself that directly
interested subjects can benefit from and then represents an adequate measure to rate the
“economic quality” of a decision.

On the other side, it has to be underscored that the most recurring methodologies
adopted to measure profit can potentially be rough and/or misleading when extended to
the strategies evaluations so practicable algorithms and parameters need to be investi-
gated to better reflect their economic aspects. Adopting the Enterprise Value as the key
parameter to rate the strategies’ quality is the main idea widely approached during the
last years indeed.

Since the early 1990s, dimensional strategies focusing increase in sales, operational
effectiveness, differentiation in products and services, market growth, economies of scale
and major bargaining power coming from growing “critical mass” have been prominent
for the financial information and the growth in value for the shareholders. Such a situ-
aton directly comes from local public water services reforms that in many countries
introduced new concepts of competition into a general context historically characterised
by nearly monopolistic conditions operated by a restricted number of big players having
abundance of resources to grow.

Market competition rises indeed when a water company makes, with others, a tender
for the renewal or for a new contract of water service, provided by a prevailing position
granted by its know how and know why. But when the bid is concluded, the market
adjustment is hardly reconciling with the rules Vilfredo Pareto stated (OECD, 2000).
Anyway, such a sort of new competition environment then broke out a general, and
sometimes frenetic, activity of Merger and Acquisition (M&A) specifically aimed at
creating critical mass when tendering.

Nevertheless, models based on growth in value for the shareholders or on correlations
between market appraisal and economic results have more recently prevailed and made
collateral the above dimensional models. It can be then derived that every projected
development has to be profitable and sustainable by granting a surplus coming from the
difference between the net income got by the project and the minimum reward for the
capital the shareholder invested in the business. According to the most recent theories,
the internal performance indicator Economic Value Added (EVA) is able to provide the
The best project evaluation as:

\[ EVA = EBIT - (WACC \times IC) \]  

where,

- **EBIT**: is the earning before interests and taxes,
- **WACC**: is the weighted average capital cost, and
- **IC**: is the total invested capital.

Value has been created when EVA is positive and the adopted strategy can than be rated as economically viable. Market can perceive the utility value by the external performance indicator Market Value Added (MVA) that is:

\[ MVA = MV - E \]

where,

- **MV**: is the market value (stock exchange capitalization), and
- **E**: is the equity value invested by shareholders.

MVA expresses indeed very clearly how the adopted strategies can be economically ranked because it quantifies (through the actualisation of future EVAs) the evaluation market is recognising to the future ability by the utility to efficiently allocate its capital and create equitably reward.

The above given, speeding the water business change strongly requires profitable and sustainable strategies, that maximise the achieved know how and exploit the synergies depicted by development perspectives, supported by detailed business plans both medium and long term oriented, where organisational adjustments and needed resources are unequivocally identified.

Planning strategies schedule analysing the impacts they induce on the current reality so that areas of potential intervention can be identified and prospective organisational models can be accurately tailored to gain the projected recovery in efficiency and effectiveness.

Just a few self-explaining remarks about particular aspects affecting water development strategies design. High care needs to be taken of the specific targets of service quality and environmental protection the Regulators fix to the operators, which cannot be resigned and turn into well-identified business and cost drivers (Saghir, 2003). Customer expectations and service care that every day boost water professionals to improve their performance by lowering costs, enhancing revenue collection and increasing the level of provided service need to be accurately considered as well.

Just at last IWA World Congress held in Marrakech on September 2004 many case studies pointed out the relevant importance played all over the world by different issues impacting on pricing and finance strategies as the key factor able to improve water utilities’ financial status. The pivotal need has been stressed to facilitate efficiently informed and consistent decision-making, so that market based instruments could be adopted when deciding about resources allocation and the economic objectives could be more strictly aligned with the institutional arrangements of water reforms (UN, 2004).

**Conclusions**

Nevertheless cost recovery principles might be not always realistic in developing areas with regard to the low payment customer’s capacity. Affordability aspects play then a consistent role when designing water industry pricing policies and strategies and require to be closely considered so that the socio-economic sustainability could be assessed into a carefully balanced and effectively integrated regulation (OECD, 1999).
reasons, strategies in developing areas need to tackle the difficulties, due to some weaknesses in governance systems, that can be encountered in both following a more robust sustainable development pathway and balancing socio-economic needs with environmental sustainability. Nevertheless a Chinese saying goes “If we are not changing the way, we could end just where we are going to” so to timely see how the organisation can do more with less is the best approach to correctly implement strategies focused to achieve profitable and sustainable development.

So doing, the experiences by other market players and generally accepted KPI to correctly compare with are of pivotal importance to properly analyse costs and benefits coming from the projected strategies and to re-design business processes in depth (Saghir, 2003). On such a purpose Benchmarking, which implies finding out how others do their job, whether they are more efficient than we are and, if so, whether we can understand and use their methods to our advantage, can be a powerful and helping tool supporting the management, provided that it is accurately planned, correctly operated and clearly determined.

Beyond any doubt this becomes more easy where a Benchmarking Clearinghouse exists that manages the different stages of set up, collection and data processing, as well as the communication to the companies sharing the project.

IWA, through specific Task Forces operating inside its Operation & Maintenance and Statistics & Economics Specialist Groups, recently developed useful guidelines dealing with both metric and process Benchmarking in order to support water decision makers with an overall perception of the utility performance basis to make strategic choices and positively address issues of efficiency (Alegre et al., 2000; Larsson et al., 2002). It can be thus agreed that today’s competitive business climate requires the water industry to become more cost-effective while delivering high-quality products and services. To achieve this and best respond to the competitive challenges, managers must strategically promote efficiency and lowering costs, being concerned with what efficiency is and how to measure it.

As management maven Peter Drucker writes: “We need to measure, not count”!

References