

# **WATER INDUSTRY COMMISSION FOR SCOTLAND**

## **Business Plan Guidance for Retail Licence Applicants**

SEPTEMBER 2005

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### **Appendix A Definitions for Tables**

Attached separately

### **Appendix B Tables to be completed by Applicants**

Attached separately

## General Guidance and Introduction

### Introduction

Section 7 of the Water Services etc. (Scotland) Act 2005 requires that in considering a licence application and an applicant's ability to perform adequately the activities authorised by the licence, the Commission is to have special regard to:

1. knowledge, expertise and experience
2. financial acumen and business viability
3. such other matters as the Scottish Ministers may by order specify.

The applicant's business plan is a key document in support of the applicant's licence application and offers the applicant an opportunity to demonstrate that it satisfies the criteria set out above. This business planning guidance has therefore been prepared to assist the applicant. It is structured into the following sections:

- general guidance for completion and assessment criteria
- business plan section headings, with
  - a series of questions to be answered under each of these headings
  - Water Industry Commission (the Commission) criteria for assessing the business plan
- Appendix A containing detailed definitions of the tables that are to be submitted as part of the business plan
- Appendix B containing the tables that are to be completed by the applicant.

**Note: In terms of Paragraph 1(7) of Schedule 2 to the 2005 Act, any applicant for a water services licence or a sewerage services licence who knowingly or recklessly makes a statement, in connection with the application for the licence, that is false or misleading in a material particular is guilty of an offence.**

## General Guidance and Introduction

### General Guidance for Completion

Applicants should bear in mind the following points:

- The specific guidance set out at the beginning of each section is designed to be a helpful prompt to the applicant, but it should not be viewed as a prescriptive set of instructions.
- Providing answers to the business plan questions is the essential minimum required and the Commission expects the applicant to provide comprehensive evidence to support its claim that it has the **managerial**, **financial** and **technical** capability to perform adequately the activities authorised by the licence.
- The purpose of the business plan is to assess the applicant's approach to undertaking licensed activities. To that end the business plan should address the applicant's approach to only those licensed activities.
- The business plan should demonstrate that the applicant's licensed business will be suitably independent of and ring-fenced from the applicant's (or its parent's) other activities.
- Applicants should highlight any assumptions made in preparing the business plan and detail the analysis behind those assumptions.
- If the applicant is applying for both a retail water licence and a retail sewerage licence then they will be required to submit only one joint business plan, however, the applicant should distinguish between water and sewerage services.
- The applicant should highlight (explaining its reasons) any information which it would not wish to be published or disclosed by the Commission in due course.

In particular, the applicant should set out clearly whether, and for what length of time, it considers the information submitted to be subject to any exemptions under the Freedom of Information (Scotland) Act 2002.

The Commission will have regard to any such requests when considering future publication or disclosure.

- Applicants should follow the prescribed structure, as follows:
  - Director sign-off
  - Executive Summary
  - Corporate Structure & Management Team
  - Market & Operating Environment
  - Corporate Strategy
  - Delivery

## General Guidance and Introduction

- Financial Information
- The applicant's business plan should cover as a minimum the period to the end of the 2009/10 financial year (31 March 2010).

### **Evaluation Criteria**

Each section sets out the evaluation criteria against which the Commission will evaluate the business plan in support of the applicant's licence application.

When considering an applicant's submission, the Commission will have regard to the following for all sections of the Business Plan:

- the completeness, detail and reasonableness of the assumptions
- documentary evidence of Director, Chief Executive or Chairperson formal adoption of the Business Plan
- consistency across and between all sections of the Business Plan.

## Corporate Structure and Management Team

### Purpose of the section

*The purpose of this section of the business plan is for the applicant to demonstrate that it has the knowledge, expertise and experience to operate a licensed water and/or a licensed sewerage retail business. The applicant should also ensure that it demonstrates that the business will comply with best practice corporate governance. As set out in the general guidance, it is essential for the applicant to demonstrate that its retail water and or retail sewerage business is suitably independent of the applicant's (or its parent's or associate's) other activities.*

### Outline of Issues to be Addressed

In order to demonstrate this managerial and technical ability, the applicant should ensure that the following questions have been addressed:

- What is the organisational structure of the business?
- What are the key roles within the organisation and their associated responsibilities?
- What skills does the applicant believe are prerequisites of those key roles?
- Who has been identified to fill those key roles?
- Do these people have the skills necessary to fulfil the requirements of the key roles? (Applicants should include the CVs of those people who have been appointed to the key roles.)
- What are the applicant's legal/corporate governance arrangements?

### Evaluation Criteria

When evaluating the applicant's submission on its corporate structure and management team, the Commission will have regard to the following:

- Organisational structure
- Relationship and trading arrangements with parent company
- Corporate governance
- Corporate communication
- Delegations of authority
- Key positions and the associated roles and responsibilities
- Managerial, technical experience required for key positions
- Personnel and knowledge transfer from parent company
- Individuals to fill key positions.

The Commission will evaluate whether the organisational structure identifies the key roles and responsibilities that an applicant will need. It will also evaluate

## Corporate Structure and Management Team

whether the management team proposed by the applicant has the required knowledge, expertise and experience to run a licensed water and/or a licensed sewerage retail business.

Particular attention will be paid to the technical and managerial competence of the individuals proposed for key positions.

The applicant will also need to demonstrate that the business will comply with best practice corporate governance and that the management team will be independent and will be able to commit the necessary time to the business.

## Market and Operating Environment

### Purpose of the section

*The applicant should use this section to demonstrate knowledge of the environment within which a water and/or sewerage services provider will be operating. In particular, the applicant should address the following questions:*

### Outline of Areas to be Addressed

- What is the applicant's understanding of the regulatory and legislative environment within which a licensed retail business will operate?
- What does the applicant believe are the prerequisites for a successful business?
- How does the applicant expect the macroeconomic climate to impact upon the business?
- What does the applicant believe are the key opportunities, risks and uncertainties facing the retail water and sewerage services market? As a minimum, the applicant should address this question in relation to the following areas:
  - Customer segmentation
  - Customer base
  - Competitor activity
  - A single monopoly supplier in Scottish Water wholesale.
- Does the applicant believe that the wholesaler's method of charging could affect the retail market and if so, how?

### Evaluation Criteria

When evaluating the applicant's submission of its market and operating environment, the Commission will have regard to the following.

- Regulatory and legislative understanding
- Perception of success factors for a business operating in the market
- Understanding of the competitive environment and the impacts it may have on the business
- Macroeconomic forecasts
- Understanding of the opportunities, risks and uncertainties in the market
- Customer base
- Wholesale/Retail relationship.

The Commission will evaluate whether the applicant has demonstrated that it has the requisite knowledge of the markets and operating environment in which a water and/or a sewerage retail business will function. Particular attention will

## Market and Operating Environment

be paid to the applicant's knowledge of how the market will develop in terms of regulation and competition over the forthcoming period.

## Corporate Strategy

### Purpose of the section

*In this section, the applicant should set out its strategy for operating in the market and environment that it identified in the preceding section. This section of the business plan is a crucial element in demonstrating the viability of the business. The applicant should ensure that the questions below have been addressed.*

### Outline of Areas to be Addressed

- What is the applicant's strategy for the business? In particular:
  - Which customers will the applicant be serving?
  - What costs will be incurred in servicing those customers?
  - What revenue will accrue from those customers?
  - Does the applicant believe that these factors will change over time and if so, how?
- How is the applicant's strategy applicable to the market and operating environment that it identified in the preceding section?
- Why does the applicant believe that its strategy is sustainable in the market and operating environment that it discussed in the preceding section?
- What are the key objectives for the business?
- What are the timescales for delivery of the key objectives?
- What impact will the proposed strategy have upon customers? For example, how will the level of service to customers be affected and how does the applicant propose to measure this? (If appropriate, the applicant should differentiate between customer groups.)
- What pricing strategy does the applicant propose to adopt with its customers?

### Evaluation Criteria

When evaluating the applicant's submission on its corporate strategy, the Commission will have regard to the following:

- Strategic thinking
- Consistency with information in Business Plan
- Impact on customers
- KPIs identified
- Financial implications
- Sensitivity analysis

## Corporate Strategy

- Timing.

The Commission will evaluate the strengths and weaknesses of the applicant's overall strategy for operating in the markets specified in the application. Particular attention will be paid to the robustness of the strategy in demonstrating the viability of the business.

## Delivery

### ***Purpose of the section***

*In this section, the applicant should set out the resources that it believes it requires in order to deliver the strategy described in the preceding section. This section is a crucial element in demonstrating the viability of the business and the applicant should ensure that the questions below are addressed.*

### **Outline of Areas to be Addressed**

- What resources does the applicant need to deliver its strategy? The applicant should address this question in relation to the following:
  - Assets required, for example call centres and IT. This should be at a high level and cross referenced with the opening balance sheet where it is intended that the assets will be owned by the applicant. Where the assets are not to be owned, the applicant should outline from whom (and on what commercial terms) the principal assets will be leased/main services outsourced.
  - Staff required (numbers, roles etc.)
- How does the applicant intend to manage its customer facing processes? The applicant should link this section to the organisational structure set out in Section 2.
- How does the applicant intend to manage its relationship with the wholesaler (Scottish Water)? The applicant should include details of the Wholesale Service Agreement and Service Level Agreement that it proposes to enter into with Scottish Water. The Commission expects that these Agreements will clearly set out all of the services that the applicant intends to purchase from Scottish Water.
- What wholesale charges does the applicant expect to pay, in particular whether the applicant will pay tariff or seek a special deal with Scottish Water (eg Back to Back special agreements)?
- What provisions has the applicant made to deal with emergency situations and issues of security and what allowances have been made for associated costs? For example, how will the applicant work with the wholesaler to manage and resolve emergencies such as drinking water contamination and what resources would be required?
- What provisions has the applicant made to manage operational incidents? For example, how will the applicant work with the wholesaler to manage and resolve operational matters such as planned and unplanned interruptions to supply and metering issues?

## Delivery

- Evaluation Criteria

When evaluating the applicant's submission on how it plans to deliver its strategy, the Commission will have regard to the following:

- Allocation across business sections
- Resource requirement
- Resource allocation
- Staffing requirement
- Staff transfer from parent company
- Training programmes
- Procurement
- Systems (requirement and separation from parent company)
- Cost implications
- Wholesale Service Agreement
- Service Level Agreement.

The Commission will evaluate the applicant's resource requirements in order to deliver the strategy set out in the business plan. Particular attention will be paid to the clear understanding of how the assets required to operate the business will be sourced, what staff will be required and what services will be outsourced.

## Financial Information

### ***Purpose of the section***

*The applicant should demonstrate its financial acumen and the viability of the business that it has proposed in the preceding sections. The Commission expects the applicant to provide the financial information set out below.*

### **Outline of Areas to be Addressed**

- Relevant financial assumptions
- Information regarding the funding arrangements of the business, in particular, the capital structure and working capital arrangements
- Assumptions regarding the costs of the supply chain
- Detailed analysis of start up assets, and activities
- Comprehensive list of starting fixed assets, including source of assets, and estimates of transfer fair value
- A financial plan covering the period of the business plan, including as a minimum:
  - Profit and loss
  - Balance sheet
  - Cash flow.
- Forecasts of revenue. The applicant should ensure that revenue forecasts are consistent with the customer segments identified previously.
- Details of relevant accounting policies.
- Details of any measures (e.g. ring fencing) that the applicant and its associated companies believe are necessary to ensure appropriate arm's length trading between themselves. The applicant must be able to demonstrate compliance with transfer pricing rules in line with the principles set out in WICS Regulatory Accounting Rule 5 (Transfer Pricing in the Water Industry – Scotland).
- Risk and sensitivity analysis. The applicant should explain any risk and sensitivity analysis that it has undertaken and set out the resulting impact upon the business. In addition, the applicant should explain how such risks can be mitigated.

## Financial Information

### **Evaluation Criteria**

When evaluating the financial information contained in the applicant's submission, the Commission will also have regard to the following:

- Financial sustainability of the business
- Robustness of data
- Sensitivity analysis
- Funding arrangements
- Consistency with the rest of the Business Plan
- Cost allocation
- Accounting policies
- Financial ring fencing arrangements.

The Commission will evaluate the applicant's financial acumen and sustainability in relation to the information that has been supplied in other sections of the Business Plan. Particular attention will be paid to the internal consistency of the financial information and the assumptions underlying the financial plan and the risk analysis.

It should be noted that the Commission will test whether the applicant has related the detailed financial projections and assumptions contained in this section to those made elsewhere in the Business Plan.