



MARCHMENT HILL

- consulting -

That was then, this is now: paradigm shift in water industry retail

- Consumer priorities are now dominated by “value for money”
- Retailers need to reflect these priorities and manage their changed risk
- Increased regulatory engagement and adaptability is key

The operating environment for water retailers has undergone a significant shift in the last two years. Consumer attitudes, needs and expectations are changing in response to the ending of regional droughts, and completion of major supply security capital investment programs. The compliant and accepting attitude of consumers during water scarcity conditions has been replaced with concerns about rising prices, a reduction in the need (or, more accurately, the willingness to pay) for demand management, and external financial pressures - all are driving an increased focus of water consumers on receiving “value-for-money” services. Water retailers must now adapt their businesses to meet these current consumer demands.

What has changed?

Through the mid- to late-2000s, the focus of Australia’s water industry was on ensuring supply security. Prolonged drought, constrained planning, ageing infrastructure, and the impact of population growth placed pressure on stressed collection and supply systems and the capital investment programs to maintain them. To buy time for investment in supply options, ever-tighter water restriction programs, including rising prices, were imposed on consumers. With the co-operation of consumers, the desired response was achieved: in South-East Queensland, daily usage dropped from pre-water restriction levels of 300 litres/person/day to under 140 litres/person/day between April 2005 and September 2007*.

However, the past two years have witnessed easing drought pressures in many jurisdictions. Dam levels have risen, restrictions have loosened, and with the completion of several desalination, pipeline and recycled water programs, supply security is no longer considered an immediate risk. The enduring impact of these years, though, is the heightened level of engagement consumers now have with their water use - and what they pay for the privilege.



Figure 1: Water prices are now subject to unprecedented levels of media scrutiny.

Simultaneously, the on-set and continuing impacts of the Global Financial Crisis (GFC) have driven an increased consumer focus on household expenditure. Rising water prices, which were more acceptable to consumers during the drought when consumption was low, are now being openly and forcefully questioned - both by the community and the media (see Figure 1) - as they rapidly out-strip growth in average household income (see Figure 2 below).

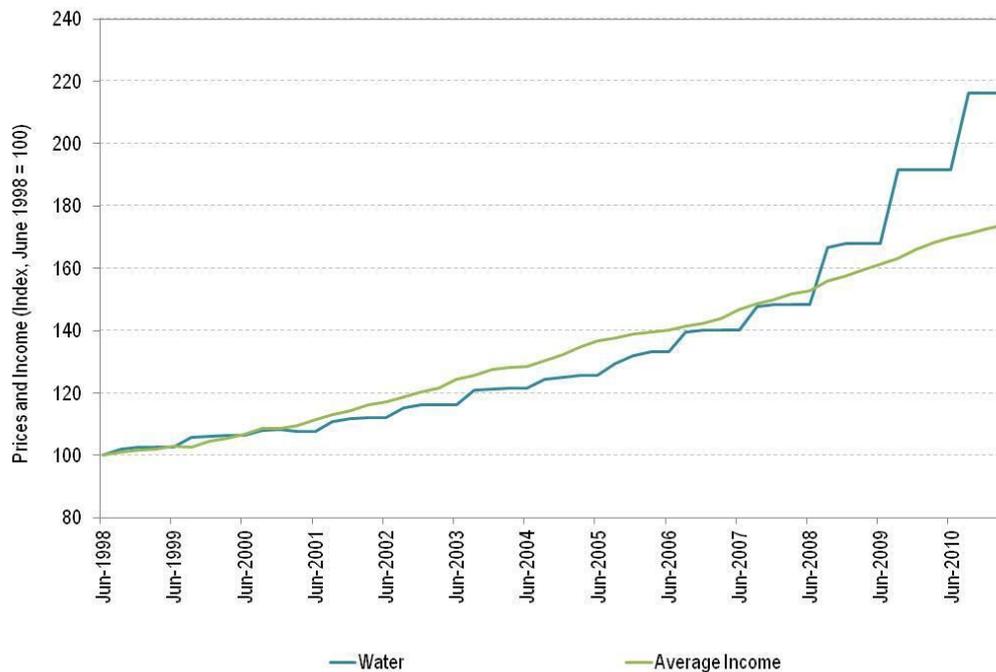


Figure 2: Rate of increase of water prices versus average income 1998 - 2010 (source: ABS)

Water retailers in Victoria, South-East Queensland, New South Wales, Western Australia and Tasmania have been subject to an unprecedented level of scrutiny. The intense public debate behind the demise of Allconnex Water in South-East Queensland was largely driven by perceived imbalance between rising prices and the level of service provided to its customers, as

well as declining political support for rising prices in a harsh economic climate. The major community body involved in the debate states as its key objective: “Supplying water at the best possible price”^{**}; however, the emotive nature of the debate clearly shows that consumers are demanding more “value for money” - a sharp contrast to the apparent support (only a few years earlier) for increasing prices to sustain supply security initiatives.

“Consumers are demanding more “value for money”

What does it mean for water retailers?

This changing environment has three major implications for water retailers. Firstly, the corporate risk profile has changed and water retailers need to manage their stakeholders appropriately. Water retailers who ignore or are slow to respond to this change, risk damaging their reputation in (at least) the short term, and compromise their ability to justify capital investment programs to consumers in the long term. Unless water retailers are seen to be focused on efficiency and committed to price containment, greater transparency through regulation will expose them to increased public scrutiny. We observe in the electricity industry that the “regulatory narrative” (i.e. the dialogue which sets expectations for the future) now revolves around efficiency and cost - a stark contrast to the GFC-derived narrative of three years ago which emphasised the need for capital investment.

Secondly, water retailers need to ensure they are responsive to consumer concerns. Heightened consumer engagement increases the importance of effective delivery of valuable customer-facing functions, such as those provided in the contact centre, billing, debt management, connection services and field operations. Achieving the right mix of brand awareness and public profile in the post-drought period will ensure optimum and continued community support.

Finally, if water retailers are to justify their revenue requirements, they need to engage and communicate with consumers more effectively. Refocusing communication, from messages of “security of supply” to those demonstrating “value for money” - through the provision of optional products (e.g. agricultural, potable and recycled water), services (e.g. 24-hour contact centre or bill payment availability), or levels of service (e.g. guaranteed response or repair times) - will allow consumers to reflect their individual willingness to pay.

What will be the difference between success and failure?

Marchmont Hill believes that there are three major lessons for water retailers that will determine their success in meeting these new challenges:

- 1. Know your environment:** Understanding the demands of the customer base, economic regulation environment, and other influencing factors (e.g. government policy) is critical to setting the path forward. Clearly articulating and prioritising customer values

are essential. Particularly important to this challenge is quantifying the customer's willingness to pay for the full spectrum of products, services, and levels of service at a granular level.

2. Engage the economic regulator early and effectively: Align customer needs with the regime in advance of the investments and business model changes required to address these customer needs. The network businesses who have successfully engaged their economic regulator have had a relatively smooth path compared to those who have not. Regulation should not become a lag indicator of customer needs.

3. Adapt to prosper: Ensure appropriate processes and capabilities of the business model are adapted to successfully manage changing customer requirements in relation to products, services and levels of service. For example, the debt management function, historically of low service importance, becomes imperative in an environment where utility bills, and more specifically water bills, are increasing as a proportion of household income - this function must now actively optimise cashflow whilst minimising customer pain. By identifying and delivering greater levels of innovation and differentiated propositions, water retailers can satisfy the “value-for-money” sought by their consumers.

MHC has developed a diagnostic tool for assessing business readiness against these three domains, to develop an engagement roadmap complementing business strategic and regulatory planning.

Summary

The changing operating environment, combined with consumers' increased engagement with their water use and the rising cost of water, means consumer needs - particularly in relation to their willingness to pay - have altered dramatically in the last two years. Consumer support for initiatives securing the supply of water has been overtaken by demands for demonstrable “value for money”.

Water retailers need to quickly define and implement strategies to adapt to their new operating environment. At a minimum, these strategies should include a formal environmental examination to understand their changing corporate risk profile, ensure regulatory requirements are aligned with their changing consumer needs, and prepare to adapt their business model, particularly in the way products, services and levels of service are presented to consumers.

* <http://www.nccarf.edu.au/conference2010/wp-content/uploads/Michelle-Maloney.pdf>

** <http://www.goldcoastfightsallconnex.com.au/home/mission-statement.html>