Multi-Utilities: Policy

Promotion, Tolerance, or Control?

Some utilities have responded to recent changes in technology and market liberalization by turning themselves into “multi-utilities” that bundle traditionally distinct services. A companion Note reviews recent trends in horizontal integration of utilities. This Note looks at the policy and regulatory implications of those trends for developing countries. The question facing policymakers is whether the emergence of multi-utilities should be encouraged as a means of improving access and quality of utility services—or subjected to closer control to guard against potential dangers arising from less competition, greater regulatory complexity, and more concentrated political power in the utilities.

For the past 20 years, governments have sought to lower costs, improve service quality, and expand access to utility services such as electricity, telecommunications, and water and sanitation. Their strategy has been to liberalize markets and encourage private sector participation. To take advantage of the opening provided by governments and new opportunities created by technological developments, the private sector has adopted new corporate strategies. One strategic response has been to expand from supplying a single utility service to a “multi-utility” format in which the firm offers two or more traditionally distinct utility services.

Potential benefits of multi-utilities
In principle, multi-utilities offer several advantages.

Lower costs, increased convenience
Utilities that bundle two or more services often can cut costs through economies of scale and scope involving rights of way, physical assets, customer service functions, project development expertise, and administrative costs. A recent review of the British gas and electricity industries found, for example, that utilities dealing in both forms of energy could achieve cost savings of up to 10 percent compared to those that supplied gas alone.

The magnitude of savings will vary. And the extent to which savings are shared with consumers or accrue to shareholders will depend on the effectiveness of competition and regulation. In some cases, consumers may benefit from the convenience of dealing with a single service provider.
Critical mass
Remote communities are often too small to attract the attention of private investors in a single utility service. Bundling several services together in a multi-utility may help to provide critical mass and thereby reduce the costs of investigating opportunities, developing projects, participating in bidding processes, and establishing a local presence. Several countries and municipalities have adopted such a strategy when privatizing existing assets (Cape Verde, Comoros, Gabon, Morocco) or extending services to rural areas (La Rioja, Argentina). Bundling also holds promise for extending services to the poor in rural or peri-urban areas.

Removing barriers to competitive entry
Competitive supply is feasible in a growing number of utility services that once were considered to be natural monopolies. But in developing countries networks are often undeveloped. New entrants may be discouraged if large investments are required to build out network infrastructure. The opportunity to leverage existing distribution networks, customer bases, and other assets put in place to provide one utility service may reduce barriers to entry for companies intending to provide additional utility services in the same market. Several countries have used this strategy to enhance competition in telecommunications services, and similar advantages may arise in other markets.

Lower political risks
Because the price of utility services tends to be politically sensitive, and investments, once made, are specific and immobile, investors are vulnerable to opportunistic government action. Firms will not invest in a country if they believe that their investment will be compromised by direct expropriation or by a succession of small regulatory actions that add up to expropriation. A firm that supplies more than one service may perceive that it has greater clout with local political authorities and thus is less vulnerable to such risks.

Potential disadvantages
The benefits of multi-utility strategies may be offset by negative effects.

Decreased competition between substitute services
Some utility services, notably power and gas, compete for the same customers in many areas. The potential for interfuel competition can reduce market power and thus facilitate regulators’ tasks. Where such competition exists, the integration of electricity and gas distribution in one firm may increase the need for supervision. The extent to which this is so will depend on the potential for competition from other service providers and the regulatory capacity of the government in question.

Other competition blockers
Multi-utilities may give rise to other policy concerns related to competition. For example, an incumbent multi-utility providing telecommunications and electrical power may be able to leverage its position in the power market to enhance its market power in telecommunications, thereby deterring competitive entry. The increased market power may flow from its knowledge of existing customers, its established brand name, or its ability to bundle services. In addition, the multi-utility may be able to allocate common costs within the firm in a way that gives it an unfair competitive advantage in the contestable business.

The risks presented by such anticompetitive strategic behavior have led to regulatory disputes in the United States and the United Kingdom. For example, the transfer of telecommunications assets to an unregulated subsidiary at prices...
alleged to be below market value triggered a high-profile U.S. court case (Boston Edison/RCN Corporation vs. Cablevision Corporation). Allegations of unfair allocation of costs in connection with dual-fuel offers brought against gas supplier British Gas Trading led to an investigation by the regulator. Where such risks arise, additional demands are placed upon regulators to investigate allegations and determine remedies. The resulting cases tend to be very complex and may constitute a significant problem in countries with limited regulatory experience and capacity.

**More complex tariff regulation**

Effective tariff regulation requires the regulator to have access to reliable information about a utility’s costs and to be able to compare those costs with industry benchmarks. Multi-utility structures have the potential to greatly complicate that process. Several of the potential advantages of multi-utilities hinge on the use of common assets to provide more than one service. Allocating the value of those assets among services for purposes of setting and regulating prices is complicated under the best of circumstances and can present opportunities for firms to frustrate the regulatory process. Problems may also arise in determining a fair return on investments during price reviews. It may be difficult, for example, to determine the appropriate cost of capital for firms that provide multiple services but rely on undistinguishable financing sources.

**Competing regulators**

Multi-utilities pose challenges to coordinated oversight by regulators, which in many countries remain organized along industry-specific lines and located at different levels of government. For example, a firm offering electricity, telecommunications, and water services may fall within the regulatory jurisdictions of three separate regulators at two or more levels of government.

Overlapping authority and uncoordinated regulation complicate regulators’ tasks and create opportunities for firms to manipulate the regulatory process. Such conditions also can increase the compliance costs of regulated firms, especially where regulatory requirements or approaches are inconsistent. Poorly defined responsibilities among regulators also may cause delays in tariff adjustments and lengthy processes for approval of changes in services. Multi-utilities formed as a result of acquisitions and mergers often fall within the jurisdiction of several industry regulators as well as the authorities responsible for regulating competition.

**Political power**

Multi-utilities may have more leverage in disputes with governments, but from the government’s perspective the accretion of political power may not be a welcome development. Indeed, the additional influence such firms may have—through their roles as taxpayers, employers, and contractors—can create instability in emerging democracies.

**When choices must be made**

Governments and regulators may need to consider the public policy implications of emerging multi-utilities at several junctures:

- Before privatization, to determine whether an integrated utility should be restructured into several distinct utilities.
- In bidding, to determine whether restrictions should be imposed bidders for about-to-be-privatized assets.
- In mergers and acquisitions, to determine whether to allow postprivatization mergers and acquisitions that would result in multi-utility structures.
- In new entry situations where incumbents in one sector seek to provide services in another.

The response by policymakers, competition authorities, and sector regulators will depend on an evaluation of the pros and cons in each industry and country and may well shift over time with changes in competition and other factors. In some cases, the arguments for multi-utility approaches may be so overwhelming that governments will elect to promote such arrangements.

In other cases, some degree of restriction may be deemed necessary or appropriate. In the latter situation three main policy and regulatory controls are available.

**Cross-ownership restrictions**

Restrictions on cross-ownership between utilities may be temporary or permanent. To protect nascent competition in the gas retail markets,
British regulators imposed temporary restrictions on electricity suppliers offering dual-fuel services in areas not yet open to retail competition in electricity. The Republic of Korea chose to allow its power utility to provide leased-line telecommunications services in competition with the incumbent telephone company only until 2002, by which time broader market competition was expected to have developed.

Governments in several OECD countries, including the Netherlands, Germany, and Ireland, have required telephone companies to divest their holdings in cable television companies and imposed cross-ownership restrictions. In the United States, the Telecommunications Act of 1996 repealed provisions that had prevented local telephone companies from providing new cable service within their telephone markets. The same legislation imposed new limitations on joint ventures by local telephone companies and cable television operators serving the same market. Such companies may not acquire more than a 10 percent financial or management interest in each other or combine to provide telecommunications or video services in the same area. Chile banned significant cross-ownership between water utilities and providers of other utility services in overlapping areas.

**Account separation and “ring fencing”**
The potential of firms to manipulate costs and engage in anticompetitive conduct or to frustrate effective tariff regulation may be addressed by mandating that the costs of each regulated business must be accounted for separately, a practice known as “ring-fencing.” For example, detailed rules may be designed to govern the allocation of joint costs, and restrictions may be imposed on transfer pricing between business lines. Rules of this kind have been developed in the United States and the United Kingdom, and a similar approach was adopted when a single concession for several utilities was awarded in Gabon. Designing and administering such rules can be difficult, however, particularly in countries with limited experience in regulating utilities.

**Coordination among sector regulators**
Coordination among industry-specific regulators may be addressed in several ways. One approach is to create multi-sectoral regulatory bodies, which have a long history at the state level in Australia, Canada, and the United States, and are increasingly common in developing countries. Indeed, the growing integration of the British gas and electrical power industries recently led to the merger of two previously separate regulators. Similarly, the accelerating convergence of the telecommunications and cable television sectors has led in South Africa and elsewhere to the consolidation of responsibility for regulating both industries.

In the absence of full integration between regulatory bodies, it may be feasible for the regulators responsible for overseeing an integrated utility to agree on common approaches to key regulatory issues and to facilitate coordination more generally through joint working groups, an approach being followed by the sector regulators in Brazil and the United Kingdom.

**Conclusion**
The emergence of multi-utilities has important policy and regulatory implications for developing countries. The potential advantages of multi-utilities include lower costs, improved customer service, enhanced competition, and expanded private investment, particularly in smaller or remote communities and in markets perceived to exhibit high risks.

At the same time, offsetting costs emerge in some situations. Those costs include negative impacts on competition, regulatory complications, and the concentration of political power. The costs and benefits of multi-utility strategies will need to be considered case by case. In many instances, it may be possible to achieve balance through carefully calibrated regulatory responses, but the feasibility of those responses must be tested against the regulatory experience and capacity of the country in question.

Dirk Sommer (dsommer@worldbank.org).

---

**viewpoint**
is an open forum to encourage dissemination of public policy innovations for private sector–led and market-based solutions for development. The views published are those of the authors and should not be attributed to the World Bank or any other affiliated organizations. Nor do any of the conclusions represent official policy of the World Bank or of its Executive Directors or the countries they represent.

To order additional copies contact Suzanne Smith, managing editor, Room I9-017, The World Bank, 1818 H Street, NW, Washington, DC 20433.

Telephone: 001 202 458 7281
Fax: 001 202 522 3181
Email: ssmith7@worldbank.org

Printed on recycled paper

**This Note is available online:**