

# Multi-Utilities: Trends

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## Blurring Industry Boundaries

**The prospect of cost savings, increased market share, and other competitive advantages is prompting more and more utilities to cross traditional industry lines and offer services in several sectors. The jury is still out on whether the cross-sectoral strategies pursued by “multi-utilities” will increase shareholder value. Even if cross-sector strategies make sense for individual firms, what are the long-term implications for consumers? This Note offers an overview of recent trends—with particular focus on horizontal integration. The question of how governments—particularly in developing countries—should respond to the emergence of private sector multi-utilities is explored in a companion Note.**

In most countries, electrical power, natural gas, water and sewerage, telephone service, and other utilities have traditionally been regarded as distinct industries, with separate firms providing each service. Exceptions to that rule are not unknown, however. Cape Verde, Colombia, Costa Rica, Gabon, and Morocco, for example, have long provided multiple utility services through integrated state-owned enterprises.

Over the last two decades, governments around the world have sought to raise the quality and expand the reach of utility services through deregulation and private sector participation. The opportunity offered by deregulation—coupled with technological developments, particularly in the field of infor-

mation and communications technology—is leading many firms in both industrialized and developing countries to move from supplying a single service to a “multi-utility” strategy in which they offer two or more traditionally distinct services. Argentina’s SEMPRA, for example, offers electricity and gas services (figure 1). MÁV integrates transport and telecommunications services in Hungary. In Chile, Metrogas offers gas and telecommunications services. Some of the large infrastructure companies in the European market, including Endesa, Iberdrola, RWE, Scottish Power, Suez Lyonnaise des Eaux, and Vivendi have diversified more broadly into an even wider range of sectors and services.



### Levels of integration

Horizontal integration of infrastructure services has occurred both at the wholesale and the retail (distribution) levels. At the wholesale level energy companies are seeking to leverage trading skills between the gas and electricity sectors. Some companies, notably Enron Corporation and Williams Corporation in the United States, have started to apply these skills for the development of bandwidth trading.

At the retail level, multi-utility strategies have taken the form of either leveraging the physical infrastructure as a conduit for a range of services, integrating retail services and customer relations, or integrating separate utilities under the same corporate umbrella.

- *Integration of physical networks.* Technological advances allow companies to supply customers with more than one service over a single backbone. Many operators offer cable television, voice telephony, data services, and remote applications for other utility facilities over a single communications network. Where distinct delivery conduits must be maintained for technical or other reasons, firms may exploit existing rights of way and save on installation and maintenance by laying and maintaining parallel physical networks.
- *Service integration.* Two or more services may be marketed to customers in a bundle. Firms that integrate their services at the marketing level may seek to leverage an existing brand or set of customer relationships and cut costs by servicing customers who subscribe to a package of services.
- *Corporate integration.* Even if services are not delivered as a service bundle and are not distributed through a common channel, integration at the corporate level may offer synergies. Firms may benefit from the assets of acquired companies—in government relations, business development, financing capacity, buildings and equipment, or administrative services.

Infrastructure companies have also diversified into related sectors as part of a vertical integration strategy, for example, by combining gas pipelines and power generation assets or by combining management of port facilities and

access railroads. While these vertical strategies raise important policy issues (such as when a utility acquires upstream gas assets and tries to block entry to the generation sector by limiting access to gas supplies), they are generally well understood by regulators and are not discussed here.

### Strategic combinations

Most of the current momentum in multisector integration involves telecommunications in one form or another, but momentum is growing in energy as well.

#### The blurring of cable, TV, and telephone

The momentum in telecommunications is driven by the convergence of voice and data services. Until recently, public voice telephony and cable television were distinct industry segments that used separate physical communication conduits. Advances in technology and the rise of the Internet over the last decade have made it possible to offer services independent of specific network platforms and to provide data, voice, and video applications over telecommunications and broadcast networks.

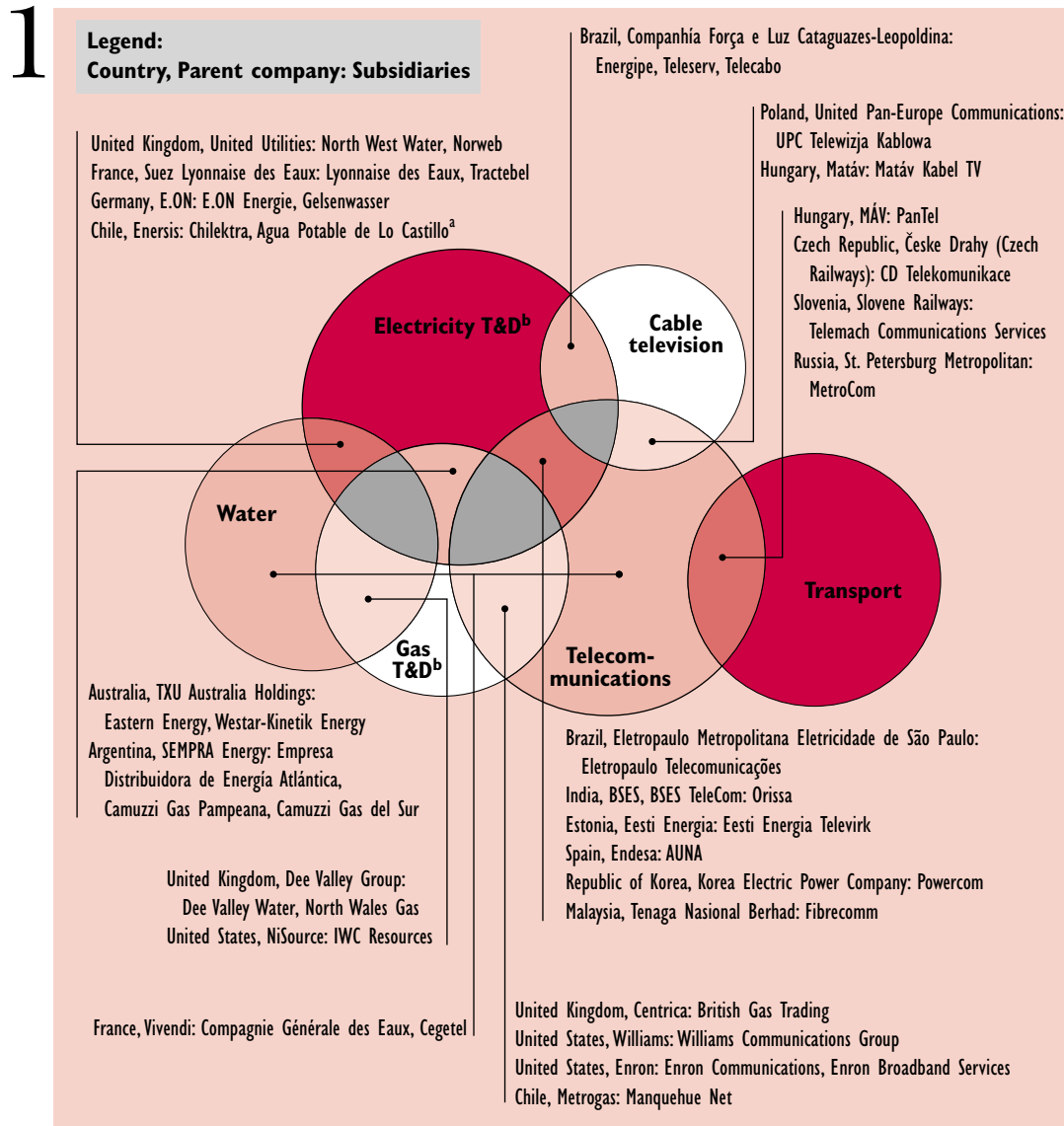
As a result, Internet service providers and cable television companies are now able to upgrade their networks to offer “voice over Internet” services that are a competitive alternative to conventional telephone services. Voice-over-Internet technology makes it possible to route telephone connections over networks traditionally licensed only for data services.

At the same time, telecommunications providers are rushing to deploy technologies that will enable them to provide data services with multimedia features over their existing copper networks. At the service level, consumers may choose from a variety of integrated communication packages that often do not differentiate between voice and data applications.

#### The rush into telecoms

The liberalization of retail telecommunications around the world has encouraged a rush of new entrants to the industry. Energy utilities, railroads, and highway and mass-transit authorities often are well placed to move into telecommunications by exploiting rights of way, existing networks, and other assets previously used only

**Figure 1 Multisector utilities—service bundling and parent-subsidiary examples by country**



a. Enersis entered the water sector in 1996 with the acquisition of Lo Castillo, but sold its interests in water utilities, including Aguas Cordillera and Aguas Puerto in 2000, following a takeover by Spanish utility Endesa.

b. T&D is transmission and distribution.

Note: Most multi-utilities currently offer services in no more than two sectors. A handful have multisector operations, however (for example, Vivendi and Suez Lyonnaise des Eaux cover four sectors). Where there are more than two sectors only the two main ones are shown in the figure.

to meet internal operating requirements. By leveraging existing assets, companies cut some of the costs and delays of rolling out a new network. The telecommunications services offered by the new multi-utilities can range from fee-based wholesale access (“the carrier’s carrier”) to retail telecommunications services bundled with other utility services. Several electric utilities around the world are field testing technologies that will allow voice and data to be transmitted directly over the electric power grid.

By the end of last year about a third of the 200 investor-owned electric utilities in the United States were offering telecommunications services under a variety of business models, usually jointly with an internet service provider or local telephone company.<sup>1</sup> In Europe, alternative communication infrastructure has played a crucial role in fostering competition.<sup>2</sup> Throughout Latin America, electric utilities already control large segments of existing fiber optic networks. In Brazil, for

example, utilities and transport infrastructure operators are cooperating in the development of long-distance backbones and new metropolitan communication networks—in competition with the existing telephone companies.

### The rise of “energy companies”

In retail markets being opened to competition, utilities are betting that bundled services—or “one-stop shopping”—will build customer loyalty and stimulate demand for value-added services such as energy-saving and safety-enhancing products and services, as well as dual-fuel heating and cooling devices. Customers who are able to choose to receive combined deliveries of natural gas and electricity can often save money.

A recent review of competition in Britain’s liberalized residential gas and electricity markets—where the gas company offers dual-fuel services to 1.9 million customers—found that consumers’ primary motive in switching from one supplier to another is to save money, and that they are more likely to switch if they can save 15–20 percent off their fuel bills.<sup>3</sup> Only firms that provide both gas and electricity services can hope to reduce prices by that margin. The study also found that many customers valued the convenience of dealing with a single provider, even without discounts. In the first three years after the phasing in of competition (in April 1996) about 60 percent (or 3 million) of all customers who had switched their gas supplier were dual-fuel clients. Only about half received a discount for taking both fuels.

### Add water and stir . . .

Combining water with other utility services is a more recent phenomenon, with prominent examples in Australia, Europe, and the United States. Although evidence of actual cost savings is difficult to obtain, the first British utilities to adopt a multi-utility strategy—United Utilities and Hyder—announced before their merger that they projected savings of between 3 and 5 percent of operating costs, mainly in overhead. If experience in the British energy markets is any indication, customers may indeed benefit from the resulting cost savings, and from the convenience of relying on a single supplier for water and energy.

### Conclusions

The traditional sectoral boundaries that have defined utility industries are eroding. Although new patterns of integration have not yet clearly emerged, firms are racing to capture the potential advantages of offering two or more utility services. Newly formed multi-utilities have promised cost savings and other benefits to their shareholders and customers, but the jury is still out on the question of whether integration will deliver as promised. Even if integration makes sense for individual firms, it is certain to have unforeseen policy and regulatory implications, particularly in developing countries. How then should policy-makers respond to new approaches to the delivery of utilities services so as to safeguard public interests without stifling innovation through restrictive regulatory controls? This question is explored in a companion Note.

### Notes

1. Edison Electric Institute (EEI). 2000. “Leaders of the Pack: Shareholder-Owned Electric Utilities in Telecommunications.” [www.eei.org/issues/news/b%2Dmatter/telebak.pdf].

2. For details on alternative networks in the European Union and Eastern and Central Europe, see European Commission, “European Survey of Information Society Projects and Actions, Synthesis of Master Reports, Central and Eastern European Countries,” 2000. [europa.eu.int/ISPO/esis/default.htm].

3. Office of Gas and Electricity Markets (Ofgem, United Kingdom). 1999. “A Review of the Development of Competition in the Domestic Gas Market.” [www.ofgem.gov.uk/docs/dcmdec.pdf]. Ofgem. 1999. “Electricity & Gas Competition Review: Research Study Conducted for Ofgem.” [www.ofgem.gov.uk/public/pub01.htm].

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## viewpoint

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