

HELM
TALKS

LECTURE SIX

OPEX

PRESENTED BY

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AGENDA

DIFFERENT KINDS OF OPEX

CAPITAL MAINTENANCE AND DEPRECIATION

THE OPEX-CAPEX BOUNDARY AND TOTEX

OPEX AND MARGINS IN A LOW ASSET CONTEXT

BENCHMARKING AND COMPARATIVE EFFICIENCY

YARDSTICK COMPETITION

MARKET TESTING AND AUCTIONS

THE AUSTRIAN APPROACH TO ASYMMETRIC INFORMATION

DIFFERENT KINDS OF OPEX

- Recurring repeat OPEX
- Incomplete OPEX and the supplier of last resort approach
- Fast depreciation OPEX
- Capital maintenance

CAPITAL MAINTENANCE vs. DEPRECIATION

- The CCA approach and Modern Equivalent Assets (MEAs)
- Capital maintenance and assets-in-perpetuity
- Depreciation and operational vs. physical MEAs
- Upgrades vs. maintenance – OPEX or CAPEX

OPEX-CAPEX BOUNDARY AND TOTEX

- The incentive to capitalise OPEX
 - Tree felling
 - Telephones
 - IT equipment
 - Vehicles
- Using leasing and use constraints vs. asset overlap and finance
- The TOTEX approach – an imperfect regulatory response

OPEX-CAPEX BOUNDARY AND TOTEX

- OPEX is asset-lite/asset-less
- Operating costs paid out of on-going revenues – cash in/cash out
- No balance sheet requirements
- Return on OPEX as a margin, not a rate of return
- Cost of capital should be irrelevant – there is little or no capital (other than “working” capital)
- Proxy is return to service-based companies, property management and facilities management

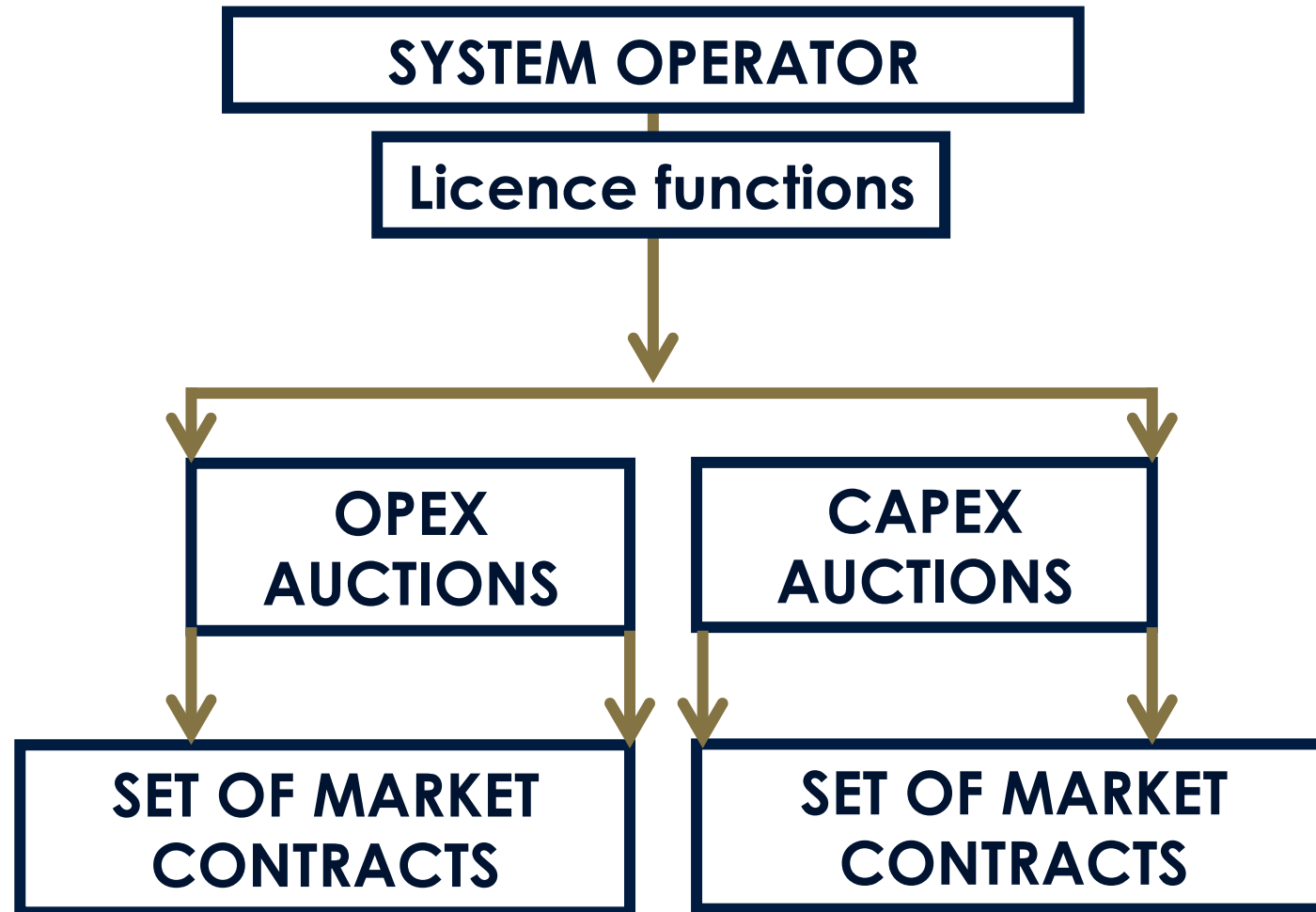
BENCHMARKING AND COMPARATIVE EFFICIENCY

- Identify costs of comparators (e.g. other water companies)
- Estimate cost functions
- Identify best practice
- Apply to the rest
- Problem over correlation – comparing apples with oranges; can always fit an equation to make any company the most efficient

YARDSTICK COMPETITION

- Economic theory model developed to set costs (and prices) as an index against the comparators
- Formulises comparative efficiency
- Suffers from all the problems of comparative efficiency
- May not finance functions

MARKET TESTING AND AUCTIONS



AUSTRIAN APPROACH TO ASYMMETRICAL INFORMATION

- Massive asymmetric information is a fact of life
- None of the above techniques will work

INSTEAD

- Set X in RPI-X on basis of crude estimation of economy-wide, productivity growth
- $X=2$
- Add extra for assumed inefficiencies in newly privatised industries
- $X=3$
- Do not interfere
- Correct at next periodic review and reset at RPI-2

SUMMARY LECTURE SIX

- OPEX is an asset-lite margin business
- There are lots of generic elements
- Competitive tendering has big advantages

**Neoclassical
approach**



Comparative efficiency,
econometric exercises

SO approach



Auction OPEX in whole or in parts

**Austrian
approach**



Crude *ex ante* number and
maximise incentives

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