



BUSINESS PLAN GUIDANCE FOR RETAIL LICENCE APPLICANTS

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CONTENTS

| | |
|--|---|
| 1. General Guidance and Introduction | 3 |
| 2. Corporate Structure and Management Team | 5 |
| 3. Market and Operating Environment..... | 6 |
| 4. Corporate Strategy | 6 |
| 5. Delivery..... | 7 |
| 6. Financial Information..... | 8 |

1. General Guidance and Introduction

Introduction

Section 7 of the Water Services etc. (Scotland) Act 2005 (“**the 2005 Act**”) 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 the applicant’s:

- knowledge, expertise and experience;
- financial acumen and business viability; and
- 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. All applicants are therefore required to submit a business plan as part of their licence application.

This guidance document has been prepared to assist the applicant by providing a helpful prompt. It is structured into several key sections and outlines a series of questions to be answered by the applicant. However, this guidance document should not be viewed by applicants as a prescriptive set of instructions.

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

Applicants should bear in mind the following points:

- Consistent with the structure of this guidance document, the business plan should, as a minimum, contain the following key sections:
 - Director sign-off
 - Executive Summary
 - Corporate Structure & Management Team
 - Market & Operating Environment
 - Corporate Strategy
 - Delivery
 - Financial Information
- Providing answers to the business plan questions outlined as part of each section is the essential minimum required. 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 those licensed activities only.
- 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.
- The applicant's business plan should provide a detailed financial overview of the current financial year, including a forecast covering the following three financial years.
- Applicants should highlight any assumptions made in preparing the business plan and provide detail of the analysis behind those assumptions.
- If the applicant is applying for both a water services licence and a sewerage services 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.

Evaluation Criteria

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

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

When evaluating the applicant's submission, the Commission will also have regard to the following key evaluation criteria:

- Whether the organisational structure identifies the key roles and responsibilities that an applicant will require. It will also evaluate 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.
- Whether the applicant has demonstrated 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.
- Whether the applicant has demonstrated that it has the necessary knowledge of the non-household retail market, including the operating environment in which a water and/or a sewerage licensed retail business would function. Particular attention will also be paid to

the applicant's knowledge of how the non-household retail market could develop in terms of regulation and competition in the long term.

- Whether the applicant has demonstrated the robustness of the proposed strategy in relation to the viability of the business. The Commission will also note the applicant's proposed level of commitment and participation in the non-household retail market.
- Whether the applicant had demonstrated that the overall approach and resource requirements are sufficient to deliver the strategy set out in the business plan. The Commission will also evaluate whether there is a 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.
- Whether the applicant has demonstrated a robust financial acumen. Particular attention will also be paid to the internal consistency, accuracy and reasonableness of the financial information, including the assumptions underlying the financial plan and the risk analysis.

2. 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 Areas to be Addressed

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?

3. 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 licensed retail business will be operating.

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 the business?
- What does the applicant believe are the key opportunities, risks and uncertainties facing the non-household retail 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 non-household retail market and if so, how?

4. Corporate Strategy

Purpose of the section

In this section, the applicant should set out its strategy for operating in the non-household retail 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 non-household retail market and operating environment that it identified in the preceding section?
- Why does the applicant believe that its strategy is sustainable in the non-household retail 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?
- How does the applicant believe that its strategy will support the active participation and contribution of its licensed retail business to the overall improvement of the non-household retail market?
- How will the applicant ensure that it upholds its service commitments, obligations and acts in line with the spirit and letter of the licence?

5. Delivery

Purpose of the section

In this section, the applicant should set out the resources that it believes it requires 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 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 with Scottish Water. The Commission expects that these Agreements will clearly set out all the services that the applicant intends to purchase from Scottish Water.
- How does the applicant intend to manage the initial Compliance Testing? The applicant should also explain how they will ensure that there are sufficient resources available to cover the full cost of the initial Compliance Testing.
- 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?

6. 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

- Details of relevant financial assumptions.
- Details of relevant accounting policies.
- Information regarding the funding arrangements of the business, in particular, the capital structure and working capital arrangements.
- A financial plan covering the period of the business plan, including as a minimum:
 - Profit and loss
 - Balance sheet
 - Cash flow.
- Comprehensive list of starting fixed assets, including source of assets, and estimates of transfer fair value.
- The applicant should ensure that revenue forecasts are consistent with the customer segments identified previously.
- What wholesale charges does the applicant expect to pay? The applicant should link this to the Financial Resilience Statement used by Scottish Water to determine the level of wholesale charge prepayments. The applicant should also explain how it plans to manage any changes in their level of wholesale charge prepayments and what resources would be required.
- 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).
- 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.



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