

What is Benchmarking?

Benchmarking (BM) involves:

- *Measuring relative performance*
- *Comparison of 'actual' performance of a decision making unit relative to a 'reference or benchmark' performance*

Benchmarking what?

- Benchmarking can occur in several dimensions of firm performance e.g. cost, investments, quality, service
- Total vs. partial (firm level vs. activity level)

Benchmarking against what?

- The accuracy of a benchmark is only as good as the comparators

HOW IS BMI Used?

Assessing the efficiency of public departments:

– Police, Hospitals, Schools, University Economic departments

Regulation of SOEs and regulated privately owned companies

Independent academic

Voluntary benchmarking

Interest parties and advocacy

The Process of Benchmarking

Identify comparator group of firms

Identify range of methodologies

Identify inputs, outputs, and environmental variable

Collect data on a consistent basis

Conduct analysis

Generate efficiency differences

Determine efficiency requirements / X-factors

Calculate price/Revenue caps

Assessing Methods: Consistency

Conditions (Bauer et al., 1997)

Different approaches should have comparable means, standard deviations, and distributional properties

Different approaches should rank firms in approximately the same order

Different approaches should identify mostly the same firm as best and worst practice

All approaches should demonstrate stability over time

Efficiency scores should be consistent with competitive market conditions

Measures should be consistent with non-frontier performance measures

Regulatory Experiences

Benchmarking correlated with competitive generation

A range of techniques being used

Leading countries exhibit high degree of transparency

Benchmarking using international data held up due to

lack of standardised data

However process of reaching international

benchmarking capability accelerating

Strategic Behavior

Choice of method (e.g. TFP vs Frontier)

Choice of technique (e.g. DEA vs SFA)

Choice of model (e.g. CRS vs VRS)

Definition, weights, and level of variables (e.g. controllable costs, customers vs. meters)

Comparability (weather, density, ...)

Mergers

Stand Up Please?

At present, no one best measure - the issue of choosing the best method can not be settled on theoretical grounds

The practical nature of the issue underlines the importance of “processual” aspect of utility BM and regulation

Good process - transparent, participatory, consensus based

Disputes: The Dutch Case

Imprecisely drafted legislation, ambitious timetable (18 months)

Disagreements w. companies and court cases
Customers lost €300 mil.

Image of deregulation tarnished - negative both for the industry and regulator

Bill of July 2004

Tightened regulatory framework

Fines up to 10% of group revenue

Ownership separation of distribution

Developing Countries

Significant scope for efficiency improvement in LDCs (e.g Mota, 2004; Estache et al., 2002)

More regulators likely to adopt benchmarking

However,

- Many concessions have been s.t. renegotiations
- Price Caps renegotiated more often than ROR (Guasch, 2004)

Tension/break-down in the relationship between regulators and firms is undesirable

Even within country factors influence the pace and effectiveness of reforms: India – Sen and Jamasb (2010)

Regulation & International B&M

Markets / firms becoming increasingly international

Enables regulators to use a wider range of techniques

Can shed light on distinctive features of the sector
e.g. operating environment, regulatory framework,
scale of firms

Can measure performance relative to world best practice

Reduces the effect of M&A on efficiency scores and loss of information

International Benchmarking

Standardisation of data - problematic across countries

Continuity - commitment to long-term co-operation

Trust - should be able to rely on each others' quality of data and timing of submission

Increased transparency - possibilities for dissemination of data and results

Increased convergence - same sets of data will encourage standardisation of technique and models

Lessons for Companies

Lots of revenue rides on the outcome of regulatory benchmarking exercises

- Know the techniques and their shortcomings
- Need to be able to understand regulatory findings
- Need to examine possibilities for strategic behaviour

Benchmarking is a powerful tool internally

- Companies have superior information which allows many processes to be compared

Benchmarking is important externally and in merger analysis

- You are being benchmarked by potential raiders and suitors

LESSONS FOR THE REGULATORS

Cost linked benchmarking is necessary in the early period of regulation

Determination of cost data at unbundling is crucial (audits, technical studies, adjustments)

Reliance on one technique is dangerous - discretion should be exercised

Conduct sensitivity analysis of preferred models

Use judgment in the use of benchmarking results

Design of X-factors should take gaming into account

Compare costs in review vs. non-review periods

Can motivate desirable behaviour (e.g. mergers)