DETERMINING THE EFFICACY OF CONSOLIDATING MUNICIPAL ELECTRICAL UTILITIES IN ONTARIO

Dr. Philip R. Walsh, Ted Rogers School of Management, Ryerson University, 416-979-5000, prwalsh@ryerson.ca
Olalekan Ajibade, Yeates School of Graduate Studies, Ryerson University, 416-979-5000, olalekan.ajibade@ryerson.ca

Section 1: Overview

From 1998 to 2000, Ontario's power sector began to undergo a provincial energy policy-driven restructuring, requiring among other things, municipalities to make corporate their electrical distribution assets. This resulted in the encouragement of mergers and acquisitions. By the end of the year 2000, Ontario's electricity distribution sector had contracted from over 300 distribution entities to about 90 entities. Since the early 2000's, a continuing trend of mergers, sales and acquisitions has further reduced the number of municipally-owned electricity distributors to a little over 70 as of December, 2015.

The major driver for the restructuring was the need to take advantage of the economies of scale that came with having a few very large electrical utilities rather than several small utilities. It was anticipated that with the mergers, there will be increased operational efficiency in terms of generation, transmission and distribution of electrical power to consumers in Ontario, and improvement in the cost-effectiveness of the merged electrical utility, which should ordinarily translate to more affordable electricity for the consumers and profitability for the companies. In theory this should be the case but, currently, there is no clear evidence to prove if these operational and financial efficiencies have been achieved or can be achieved (Saastamoinen et al, 2017; Kwoka and Pollitt, 2010). Following on the work of Kushner and Ogwang (2014) who found that costs increase with size of the merged utility, this paper examines the history of the Ontario power sector restructuring and its outcome to understand if it has been able to achieve the original goal. Specifically, we address the following questions:

1. Did the mergers of Ontario power electrical utilities lead to better cost-effectiveness and higher operational efficiency of the merged companies?
2. Have the merged Ontario electrical utilities been able to leverage economies of scale of the larger merged company to achieve improved financial and operational efficiencies?

Section 2: Methods

The theoretical approach taken was a combination of exploratory and descriptive. The research compared data for 3 years before and after the merger or acquisition of 16 municipal utilities using information available in the public domain filed with the Ontario Electricity Board (OEB) in the form of Annual Electricity Distributor Yearbooks. Such information included selected financial data related to annual revenues, costs and capital structure as well as operating data pertaining to quality and reliability of service. Given that the data is a combination of parametric and non-parametric data we applied a t-test and a Wilcoxon signed-rank test to determine statistically significant changes in financial status, operating costs and quality measures.

Section 3: Results

Our completed findings indicate statistically significant increases in debt as a percentage of shareholder equity in post-merger/acquisition utilities and consequently leveraged higher returns on equity. However, there were no statistically significant changes in service costs or quality measures (with the exception of decreased efficiency in telephone response) arising from the mergers or acquistions of electrical utilities. Our results suggest that the mergers or acquisitions to date have served only to increase shareholder risk while exhibiting no statistically significant improvement in operational efficiencies contradicting the rationale behind the Province's merger policy which suggested there would be economies of scale that would result in lower operating costs and better service quality. The findings do support the policy's goal of greater return to the municipal shareholders of the merged utility however this has been obtained through the increased leveraging of debt. Controlling for the relative difference in customers, urban service area and customer density we find that the larger the acquiring utility the greater the increase in operating expenses per customer post-merger/acquisition consistent with the findings of Kushner and Ogwang (2014). However, we did find that mergers or acquistions by more urban utilities were moderately associated with decreased debt as a percentage of assets, increased liquidity and more efficient urban emergency response post-merger/acquisition. Nevertheless, our results are consistent with more generalized industry research that suggests that the majority of mergers and acquisitions fail to meet the strategic intent behind them (Chatterjee and Brueller, 2015; Grant, Jordan and Walsh, 2015).

Section 4: Conclusions

Our results raise concerns regarding the existing merger policy for municipal electricity distributors. Failure to generate statistically significant improvements in cost reduction or service quality has most likely resulted from failure during the due diligence process to recognize the "people issues" and other qualitative factors that result in poor implementation of the merger strategy. This early evidence suggests that the existing merger policy may need to be reviewed to determine whether a more detailed examination is required by the provincial energy regulator, OEB, before approving mergers between municipal electricity distributors. To date, no merger or acquisition has been turned down by the OEB and this "fait accompli" approach may need to be challenged. Our research was limited by its small sample (n=16) statistical methodology and deeper knowledge would be gained through specific qualitative research of the impacted utilities.

References

Chatterjee, S. and Brueller, N. N., 2015. A new M & A methodology: five lessons in anticipating post-merger resource interactions and challenges. Strategy & Leadership, 43(4), 26-37.

Grant, R., Jordan, J. and Walsh, P.R., 2015. Foundations of Strategy. Cdn Ed., Wiley, Toronto.

Kushner, J. and Ogwang, T., 2014. Local Electrical Utilities—Is Bigger Better?. Canadian Public Policy, 40(3), pp.283-291.

Kwoka, J. and Pollitt, M., 2010. Do mergers improve efficiency? Evidence from restructuring the US electric power sector. International Journal of Industrial Organization, 28(6), pp.645-656.

Saastamoinen, A., Bjørndal, E. and Bjørndal, M., 2017. Specification of merger gains in the Norwegian electricity distribution industry. Energy Policy, 102, pp.96-107.