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IN ASSOCIATION WITH:

**BRAXTON ASSOCIATES
DRT CZECHOSLOVAKIA
ICF RESOURCES, INC.**

**ENERGY AND TELECOMMUNICATIONS SECTOR ASSISTANCE
IN THE CZECH REPUBLIC**

PROPOSED STRUCTURE FOR FINAL PRE BUSINESS PLAN

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**PROPOSED STRUCTURE
FOR FINAL PRE BUSINESS PLAN**

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Date: 19 December, 1991
To: Mr. Kanda
Mr. Salek
PRE working group members
From: Mark Hernon
Subject:
- proposed structure for final PRE business plan
- comments and suggestions on the existing draft business plan
- other areas of interest
- work plan, schedule, and deliverables for 1992

PROPOSED STRUCTURE FOR FINAL PRE BUSINESS PLAN

The following outline presents a practical structure for PRE's final business plan, including headings for major sections and a brief description of the information to be included. Much of this information already exists in PRE's draft business plan, and the outline cites sections of that document where relevant information appears (underlined).

Purpose and Status of Document

Presents a brief description of the intended audience, the purpose, and the current status of the document, as well as a description of any work yet to be completed.

- not included in draft business plan

Executive Summary

Presents a brief synopsis (1 to 2 pages) of the contents of the plan, and hence is written last.

- not included in draft business plan

Description of Business

May include a mission statement, which defines in broad terms the philosophy and/or long term goal(s) of the enterprise, and serves as a standard by which decisions should be judged.

Describes the products and services which the enterprise offers, the major activities which the enterprise performs in the course of providing those products and services, and the geographic territory in which the enterprise operates. Also includes any new businesses the enterprise plans to enter.

Describes the history, background and development of the enterprise.

Describes the enterprise's pricing policies and indicates factors which affect price (e.g. regulation).

Provides an overview of significant financial and operational measures of the enterprise, such as revenues, assets, profits, number of employees, capacity, peak load, energy supplied, etc.

Provides an overview of the network and other facilities and major assets which the company employs. May also include a description of important technologies employed.

Describes the enterprise's internal organizational structure, as well as its relationship with important suppliers (e.g. CEZ) and any other existing or planned relationships, such as subsidiary companies, joint ventures, etc.

- introduction to draft business plan
- section 2.0 of draft business plan
- section 6.0 of draft business plan
- section 7.0 of draft business plan
- section 8.0 of draft business plan

Strategic Objectives

Presents the major goals of the enterprise over the time period covered by the business plan. These objectives should be specifically defined and quantified wherever possible (e.g. profits of xx Kcs, dividends of YY Kcs, system reliability of zz%, etc.)

The remainder of the business plan is intended to describe the actions the enterprise will take and the investments it will make in support of these strategic objectives, as well as factors which affect its ability to achieve them.

- introduction to draft business plan
- section 4.0 of draft business plan
- section 6.0 of draft business plan
- section 7.0 of draft business plan
- section 8.0 of draft business plan
- section 9.0 of draft business plan
- section 10.0 of draft business plan
- section 13.0 of draft business plan
- sections 14.a1, 14.d of draft business plan

Impact of Energy Policy and Regulation

This section will reflect a great deal of uncertainty, since the regulatory framework for electric utilities is still being developed. It will attempt to use the latest available information to identify and describe likely results of that process, in the form of various possible scenarios. It will assess the likely impact of each scenario on PRE's ability to achieve its strategic objectives. This section will also describe PRE's proposals for regulatory changes, and will describe the potential benefits (to the enterprise, the customers, etc.) of each proposal.

This section will also address any federal, city, or other regulations which significantly affect the enterprise, including proposals for change.

Competitive Assessment

As PRE is a regional monopoly, the focus should be on possible sources of competition outside the electrical distribution sector. These include alternate sources of energy, self generation/cogeneration by industrial consumers, and possibly generating facilities, which could conceivably bypass the distribution network and serve industrial consumers directly. The assessment should include a description of each potential source of competition, relative strengths and weaknesses (supported by quantitative analysis such as relative costs, market shares, trends, etc.), recent significant events, apparent strategies, and the level of threat posed.

Includes an assessment of the enterprise's strengths and weaknesses, as well as the overall impact of the competitive environment on the enterprise's ability to achieve its strategic objectives.

- sections 1.0, 1.1, 1.2 of draft business plan

Market Assessment

Addresses both the energy market as a whole and the electrical market specifically.

Describes the market for the enterprise's products and services, including size, growth, segmentation, key drivers of demand, and other relevant characteristics.

Describes the customers which constitute the market, segmented appropriately. Includes information on customer needs, buying behavior, and any changes which may be occurring. Appropriate topics would include energy consumption by various industries, penetration of households by electrical appliances, etc.

Describes the overall impact of the market on the enterprise's ability to achieve its strategic objectives.

- section 4.0 of draft business plan

Power Supply

Describes the enterprise's sources of supply, including costs, availability, contractual arrangements, any restrictions, etc. This description should also include any ongoing or anticipated changes in the present situation, and attempt to project the likely results of those changes.

This section should also address the feasibility of alternate sources of supply, such as industrial cogeneration or other types of independent power producers.

Demand/Load Forecast

Based on the regulatory, competitive, market and supply environments.

Presents the forecast demand over time by customer/market segment, describes sources and levels of uncertainty, and includes key assumptions and methods used.

- section 3.0 of draft business plan

- section 5.0 of draft business plan

Major Initiatives and Investments

Presents the enterprise's top priorities for action and investment during the period covered by the business plan.

May include items such as major construction or reconstruction projects, and programs to improve metering accuracy or customer satisfaction.

Includes estimates of the resources (financial, human, other) and time required to complete each item.

- section 6.0 of draft business plan
- section 8.0 of draft business plan
- section 11.0 of draft business plan

Functional Plans

This section will consist of subsections for each major function or department within the enterprise (e.g. operations, engineering, human resources, purchasing, etc.). Required functions which do not currently exist (e.g. regulatory, customer service) will be identified in the course of developing these functional plans. Each functional plan will :

describe the function's role in the organization, its major activities, and the assets and staff employed

list the function's goals, illustrates how those goals support the strategic objectives of the enterprise, and describes the actions the function will take and the investments it will make to achieve its goals

include the standards by which the function's performance will be measured, the critical factors which will determine its success, and a schedule of milestones indicating when major events should occur

include contingency plans which detail the function's response to events beyond its control

describe the resources (financial, human, and other) that the function will require to achieve its goals

- section 2.0 of draft business plan
- section 6.0 of draft business plan
- section 7.0 of draft business plan
- section 8.0 of draft business plan
- section 9.0 of draft business plan
- section 10.0 of draft business plan
- section 11.0 of draft business plan
- sections 12.1, 12.2, 12.3, 12.4 of draft business plan
- sections 14.c, 14.e of draft business plan

Financial Results and Forecasts

Based on the enterprise's objectives, the competitive, market and regulatory environments, and the functional plans.

Includes historical and forecast results in the form of an income statement, balance sheet, and cash flow statement, supplemented by appropriate notes and descriptions (of accounting practices, assumptions, etc.)

Describes and prioritizes major investments planned over the course of the business plan, including associated cash flows and details on financing.

- section 4.0 of draft business plan
- section 9.0 of draft business plan
- section 14.b of draft business plan

Privatization Options

Describes the form of the privatized enterprise (e.g. shareholder company) and the alternative ownership structures under consideration.

Evaluates the various alternatives in terms of energy policy, costs and benefits to the enterprise, and fit with the enterprise's strategic objectives.

Identifies the enterprise's preferred ownership structure and the steps required to achieve this result, including a schedule.

- section 4.0 of draft business plan
- sections 14.a1, 14.a2 of draft business plan

COMMENTS AND SUGGESTIONS ON THE EXISTING DRAFT BUSINESS PLAN

The time already invested in PRE's existing draft business plan has been well spent; the document is in very good condition. The following comments and suggestions are not intended as criticisms, but rather as ways to improve the plan even further before submitting an abridged version to the ministry on 31 December. Any remaining points will be addressed in 1992, along with the issues described in the proposed structure above.

The plan should include the enterprise's objective(s) in terms of the privatization process (e.g. gaining access to capital) Also, the section on the proposed ownership structure should include a description of the regulations and constraints affecting this decision, such as "xx% must be reserved for the restitution fund."

The plan should also address the direct consequences of privatization, such as the formation of a board of directors, accountability to shareholders, need for an investor relations function, etc.

PRE may wish to consider related new business opportunities, such as retaining the construction plant and developing self generation/cogeneration projects for industrial consumers, inside and/or outside its service territory.

In general, PRE should carefully consider the points it lists as "weaknesses", possibly limiting the list to issues beyond its control that limit its ability to compete with other sources of energy. An example would be if PRE lacked sufficient flexibility in purchasing and pricing to compete effectively with other forms of energy. Other factors currently listed as weak points may be better positioned as strategic objectives. For example, PRE perceives its "passive sales" to be a weakness. In fact, PRE could establish an objective to form an effective marketing function to further penetrate its customer base, and thus increase sales.

More detail should be included on the supply of electricity and PRE's relationship with CEZ. The plan should include a description of the existing supply agreement, the status of current negotiations, and the results of CEZ's negotiations with other distribution enterprises. The current inequities in the regulated pricing structure, and their impact on PRE's performance should be stressed. The plan should also include an assessment of the possibility of acquiring power from sources other than CEZ.

When describing any planned investments, such as the new computer centers or installation of a transformer, estimates should be made of the financial resources required. Similarly, the costs or savings associated with adding or terminating a program or activity should be noted. An example would be the savings associated with contracting for waste disposal services, which would include the disposal of assets and reduction in the work force, versus the cost of the contract.

More detail should be provided on the reasons for various actions. For example, why will PRE:

- decentralize the organization of its dispatch system?
- establish centralized purchasing?
- establish a network of warehouses?
- etc.

If PRE determines that the construction plant should eventually be privatized separately, the reasons for that decision and a more detailed description of which activities and assets will remain with the distribution company and which will be privatized with the construction plant should be included.

Visual displays (e.g. map of network, chart depicting customer mix) can be very effective.

The proposed structure for the final PRE business plan provides a broad overview of some additional areas to be addressed in 1992. Some specific examples include:

- development of a program to measure and improve customer satisfaction
- establish a function to deal with regulatory bodies on a continuing basis
- expand on PRE's policy of contracting for certain support services
- develop a system to accurately forecast future demand
- etc.

OTHER AREAS OF INTEREST

PRE has requested assistance in several specific areas which are related to the development of the business plan. These areas are addressed here.

The issue of customer service and satisfaction will be addressed in detail in the course of developing the functional plans, as customer service represents an important function of the distribution company, and customer satisfaction is the product of good service. The customer service function includes aspects of both operations and marketing. Operations is responsible for actually providing service, while marketing measures satisfaction with existing service and identifies desired modifications. In order to improve customer service and satisfaction, PRE should undertake the following:

- identify relevant attributes of customer service (e.g. price, reliability, response time, consultation, etc) for the different classes of customers
- for each relevant attribute, assess both the relative importance and PRE's performance from the customers' perspective, in order to identify "gaps" in service
- use this information to allocate resources to areas that are important to customers, thus improving customer satisfaction
- implement ongoing programs to measure changes in customer needs and satisfaction, and to communicate to customers the steps that PRE is taking on their behalf

These steps represent a broad overview of a program to improve customer service and satisfaction. DRT will work with PRE to design the specific steps and tools required, and to incorporate the appropriate information into the business plan. However, it is unlikely that substantive results will be available before the end of the business planning process.

Determining the appropriate capital/ownership structure for the privatized enterprise is another area of concern, and will be addressed in more detail in 1992. Some preliminary thoughts include:

at the present time, the only form of debt available to PRE is bank debt, at a cost of about 16-17%. PRE has rightly determined that borrowing funds at these interest rates is not practical when the enterprise generates returns on invested capital of about 5%.

the appropriate level of debt will change over time, and will be determined by two key factors:

- the development of debt (and equity) markets in Czechoslovakia, and changes in the banking system
- the level and stability (risk) of PRE's earnings, which determine the enterprise's cost of debt and the amount of interest payments which the enterprise can support

PRE has proposed that the city of Prague participate in the ownership of the privatized enterprise, since this may make it possible for the enterprise to avoid or reduce certain taxes and fees. PRE should investigate whether or not this is likely. If not, PRE may want to discourage or minimize any participation by the city, since at some point the interests of the enterprise and the city may conflict with one another. At such a time, it may be in PRE's best interest not to have the city participating in its decision making process.

Employee ownership can provide valuable incentives, and PRE would like to encourage it. It may be useful to educate employees on the benefits of equity ownership in order to improve their level of interest.

Three other areas in which PRE has requested assistance are:

exposing PRE management to western technology, particularly in the field of meters - DRT is currently exploring alternatives to provide this exposure

options for ownership of the construction company - DRT requires a more detailed understanding of the construction company's activities and how they relate to the activities of the distribution company

informal discussions on negotiating with CEZ - DRT is currently assisting in the development of a regulatory framework, and will assist PRE in this area once the probable outcome of that process becomes clearer.

All three of these areas will be addressed in the coming year.

WORK PLAN, SCHEDULE, AND DELIVERABLES FOR 1992

The preceding sections of this memo provide an overview of the issues we will address beginning in mid-January 1992. The major steps we will undertake together, and the deliverables we will produce, are outlined below in the form of a rough schedule:

- week of 13 Jan** Meet with working group to review and confirm PRE's strategic objectives
- Clarify DRT's understanding of PRE's organizational structure and the roles of the various functions
- Assign to individuals responsibility for various functional and environmental areas of the business plan
- week of 13 Jan** Facilitate and coordinate development of
week of 24 Feb individual sections of the business plan
- week of 3 Feb** Review status of individual sections of the business plan
- 18 Feb** Present interim results to working group for their comments, questions, and suggestions
- week of 2 Mar** Prepare final financial statements and forecasts
- 10 March** Present final draft business plan to working group
- 17 March** Present final English version of business plan to working group
- 24 March** Deliver final Czech version of business plan to working group