

Using regulatory benchmarking techniques to set company performance targets: the case of US electricity

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Consolidation in many sectors has led to the formation of “groups of companies”. Extracting all the potential cost savings from these independent or separate operating units is a challenge given the absence of all the information about the specific operating characteristics and possible inefficiencies. We develop a step-by-step approach that applies regulatory benchmarking techniques to set efficiency targets for operating units. Holding company management – like a regulator – will want to set targets to encourage efficient operation. However, Holding company management - like a regulator - will need to do this without all the information on effort, costs and environmental conditions. Our approach using the parallel with regulation incorporates issues such as measurement error and potential environmental factors that could influence the underlying efficiency score. We demonstrate the approach using data from the US electricity distribution sector and show that substantial savings can be extracted using this approach that was originally developed for regulatory purposes.

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