Marker regulation and deregulation: saudi arabia electricity company case study e...

Business, Company

Introduction

Economics describes markets depending on the factors that define their competitive nature. In that respect, factors like the number of firms, their market share, market power, pricing strategies as being price leaders or price searchers as well as the ease and barriers to market entry. Therefore, markets are defined into categories of monopolistic, competitive and oligopolistic and have differences in their pricing and output decisions hence different effects and implication on the national economy. In that respect, governments tend to exercise appropriate regulation on the markets in order to achieve national objectives. In this consideration, this analysis seeks to provide a pragmatic view on competition and market deregulation citing the case of Saudi Arabia Electricity Company. To achieve this, the analysis begins by providing a background on the Saudi Arabia electricity market describing its market structure, market players, capacity, market size and distribution as well as the regulation involved. Further the analysis provides a background of regulation and deregulation citing its importance in the electricity industry, the process involved and the industry response to the change. Finally, the analysis describes the electricity market response to deregulation citing the company’s view of the change as well as deregulation’s effect on national development.

Body

- Saudi Arabia’s electricity market background

Among the factors that can be used to define and describe the Saudi Arabia electricity market are the market’s structuring, market players and their size

as well as market distribution. In addition, factors including the companies capacity and pricing which determine the challenges as well as the regulation that is needed are crucial in defining the market. Further, regulation is also a great determiner of a market's nature due to its implications on the involved companies' operations. (Samuelson & Marks, 2011)

- Market structure

Saudi Arabia electricity industry is characterized by a vertically integrated monopoly with a single entity whose organizational structure monopolizes the industry's activities of electricity generation and transmission as well as distribution. Thus, the Saudi Arabia electricity market can be described as a monopolistic market defined by factors including uniqueness of the utility with no close substitutes, high barriers to market entry with the market being heavily regulated by the government through various instruments including licensing and patenting to protect the single market player. In addition, the market is defined by non price competition due to the fact that Saudi Arabia Electricity Company is the sole market player. The market is also marked by price and output control by the single producers hence being an imperfect completion. (Azzouni, Parmesno & Al-Rashid, 2008)

- Companies

The market is dominated by Saudi Arabia Electricity Company (SEC) which is Joint Stock Company with 81% of its shareholding being held by the government and whose other shares are publicly traded and which is the fourth largest in the Saudi Kingdom by assets. The other companies in the industry include Saudi Aramco and other producers like Jubali Power,

Tihamah Company and Marafiq. (SEC, 2007)

- Market size and distribution

Being an integrated company in generation, transmission and distribution of electricity SEC’s electricity sales accounted for 85% of the total volume sold in the market in year 2006.

In 2005, SWCC accounted for 11. 95 of the kingdom’s total power generation and a 12. 35% in 2006 with a generation capacity of 2905 MW. The industry has output control through the distribution of power plants within the Kingdom by regions with their capacities as follows

- Eastern Coast 1700 MW

- Stern Coast 960 MW (SEC, 2007, 50)

- Capacity

The industry’s generation capacity by the year 2007 was 37, 154 MW* where Saudi Arabia Electricity company accounted for 83% of the output while 9% was provided by SWCC with the rest being generated by the other producers. In addition, SEC accounts for a 69% ownership of the Kingdom’s operational plants and had by December 2006 installed generation capacity equivalent to 30, 334MW* and 3120 kms underground cable as well as 33692 kms overhead lines. (SEC, 2007, 45)

- Prices

- Challenges

The industry is subject to various factors which determine the challenges that the industry players face. Among those factors are economic, technological, social, political and regulatory as well as environmental. Economic factors like inflation and exchange rate fluctuations greatly affects

the cost of production hence a challenge to the industry’s operations.

Political and regulatory factors presents challenges to the industry with different political regimes seeking to establish controls that seems effective to them hence lack of certainty in operations due to change in regulations including the licensing as well as tariffs.

Fluctuations in the supply and prices of the crucial inputs like oil present an immense challenge to the industry due to its effect on the production capacity as well as costs. (SEC, 2007)

Social problem faces the industry with the increasing concern of its effect on the society in its operation as a monopolistic market. The industry players find it difficult to be accepted by the market due to their inefficient operations

Environmental: The industry faces a challenge with their need for increased use of hydrocarbons like oil in production of electricity as demand for electricity grows while there is a growing concern over the environmental effect of the hydrocarbons. (Samuelson & Marks, 2011)

- Regulation

Saudi Arabia’s Electricity industry is highly regulated with Electricity and Co-generation Regulatory Authority (ECRA) which is a government’s authority being the major regulator through recommendations for suitable policies to the council of the ministers in order to establish market control in terms of licensing and tariffs. (SEC, 2007, 46)

Regulation focuses on achieving objectives within the industry including

- High quality of service.

- Service reliability.

- Adequate supply.

- Reasonable pricing.

These objectives are achieved through policies that seek to address consumers', technical and supply issues. Through the tariffs, the authority determines the rates that customers are charged by the companies with the current market tariffs being scale tariffs charged per kwh where the higher the consumption, the higher the tariffs charged (SEC, 2007, 57)

In addition, ECRA sets Tariffs that:

- Must be cost effective.

- Affordable.

- Are fair to the producers and the consumers.

- Are easier to implement.

- Meets government revenue requirements.

In respect to Licensing, the authority requires companies to have the appropriate licenses in order to carry out activities in the electricity industry. This relates to electricity generation, transmission as well as distribution. This has an objective of streamlining electricity development as well as monitoring the providers' reliability and quality of service. (SEC, 2007)

- Regulation and deregulation background

- Importance of the electricity industry

Some utilities are crucial to an economy's operations including electricity the

nature of utilities determines the need and extent of regulation exercised. Due to its crucial role in the economy, the electricity industry is subjected to regulations that seek to guarantee provision of reliable, safe, efficient and reasonably priced power. This is achieved through application of policies, standards, government laws and international standards as well as regulations. (Azzouni et al, 2008)

Therefore the importance of regulation to the electricity industry include

- Public interests protection in terms of access to reliable and safe electricity at economical prices.
- Consumer rights protection by ensuring that they get suitable services at fair conditions and have their grievances addressed appropriately.
- Enhance industry stability through transparency and nondiscriminatory frameworks
- Encourage legitimate and fair competition in the market which will be suitable in attracting more investors in the industry.

This is achieved through addressing:

- Consumer issues by dealing with tariffs assessments and review, resolving complaints as well as protecting the stakeholders.
- Supply issues through coordination of the market infrastructure, licensing as well as monitoring compliance.
- Technical issues through setting of the standards to be followed in the industry. (SEC, 2007)
- Utilities deregulation process

Utilities deregulation process in the kingdom is taking a path in which the government seeks to maintain controls like tariffs only where they reflect associated costs of the industry. Deregulation is being done through reduction of barriers in terms of reduced stringent licensing requirements to encourage competitive practices. To achieve this in the electricity industry, the regulatory authority ECRA has unbuded the industry into three segments of generation, transmission and distribution in order to encourage competition whose regulations are eased gradually and systematically. To achieve this, the regulators in general leave the market to operate in respect to the market forces by reducing the government's intervention in decisions regarding output and pricing. In addition the process takes the steps of: (SEC, 2007)

- Removal of entry barriers to private investors'
- Encouraging the markets large customers to generate electricity
- Customers' determination of tariff rate different from the regulators imposed rate.

Further, the process of industry deregulation considers that the market will remain monopolistic until when it will be suitable to leave the market fully to market forces determination. (SEC, 2007, 47)

- Responses to regulation changes in industries

With the increasing efforts by the government to deregulate the electricity industry in order to increase competition as well as enhance stability in supply of electricity, companies are increasingly adopting structures that will be compatible with future pricing policies and opening of the market to private investors. In addition, large consumers start producing electricity that

they can utilize as well as sell in the market and also have the opportunity to determine their tariff rates that are different from the regulated rates. (Azzouni et al, 2008)

- Electricity market and deregulation

- Industry and market change with deregulation

In a bid to enhance operations in the industry, the government seeks to promote competition through facilitation of independent electricity producers. This has resulted into companies like SEC strategizing appropriately by seeking to establish long-term agreements with the independent producers where the company can purchase the power they produce for distribution to the market. Therefore, with continued increase in competition as the government eases the regulation in all the tree phases of production, transmission and distribution, there will be distribution of market power as a number of market players dominate the market transforming from a monopolistic market to an oligopolistic market. (SEC, 2007, 47)

- Company view on deregulation

In a bid to address the possible increase in competition with market deregulation the Saudi Arabia Electricity company seeks to restructure its operations by establishing portfolios that consist of generation units. In this respect, the company will be able to:

- Optimize on its electricity generating assets.

- Achieve efficiency in terms of low costs.

- Enhance benchmarking of its performance.

- Implementation of a commercial approach to electricity supply. (SEC, 2007, 45)

- Development and deregulation

As markets changes, governments need to device means of responding with appropriate actions in order to promote and enhance national development. Such actions includes deregulation like has been adopted by the Saudi Arabia government in an effort to promote competitive market operations. In that respect, the implications of electricity industry deregulation in Saudi Arabia on national development includes: (Frank & Bernanke, 2001)

- Increase in foreign direct investments due to reduced barriers to market entry hence attracting more foreign investors.
- Increased investments in the industry as the entry barriers eases off hence increasing competition and production in general which is a boost to the national economic growth and development
- Higher output in the industry with increased competition and investments.
- Lower prices as a result of increased competition in the industry which results to improved society’s welfare which is a crucial national development measure. (Barron & Lynch, 1989)

With the above results and an increasingly competitive electricity industry, the national economy will experience improved welfare in terms of suitable prices, adequate output and reduced deadweight loss that comes with tariffs in the market. In addition, the increased investments will increase employment in the country as well as enhance infrastructural development all of which are crucial in an economy’s development. (Barron & Lynch, 1989)

Conclusion

The analysis has demonstrated Saudi Arabia electricity industry as one that has being operating as a monopolistic market with dominance by the Saudi Arabia Electricity Company (SEC) which has a vertical integration with operations in electricity generation, transmission and distribution hence having a significant market power. However, the market is also marked by significant regulations by the government in an effort to achieve efficiency in terms of quality of service as well as in suitable pricing. Such regulations have been exercised with application of instruments like tariffs and licensing. Further, in response to the changing market needs and industry factors, the government has been involved in deregulation efforts which are meant to promote competition in the market hence achieve efficiency. In response to the deregulation, the industry players including SEC have devised strategies that will position themselves in a more competitive way to address the increased competition. Further, the deregulation has been demonstrated to have implications on the national economic development including increased investments and output.

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