

# OUTPERFORMING DPCR5 AND BEYOND

What are the main strategic imperatives for success and how can the industry unlock shareholder value?

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# The electricity industry is undergoing extensive change: Linking key initiatives to outcomes will enable business transformation

We are now into the latest review period, DPCR5, and work has begun in earnest on delivering the outputs and returns needed. However as Distribution Network Operators (DNOs) execute their plans to deliver the improved levels of operational efficiency, customer service and an increasing capital expenditure programme - all encased in the strongest incentive regime since privatisation - consideration must be made to the main strategic imperatives for success in order to effectively deliver the next five years.

Across the sector we are still witnessing tactical and technical responses and management teams are being thrown back into the 'weeds'. This is combined with general perceptions that driving the cost efficiency levels required by the regulator will ultimately result in an actual inability to respond to the competing dynamics of technology and customer focus.

Added to this, is a demand for new thinking in terms of new build power network design, in order to facilitate the implementation of smart grid technology and the connection of significant distributed generation. These are unprecedented times for the industry, with a great deal of future success for a low carbon UK economy relying on the energy infrastructure being planned and built today.

## Recognising the need for change - but at what pace?

Network operators are, however, recognising the need to drive substantial savings plans to outperform DPCR5. This involves cutting £30 million - £100 million of total costs per annum. DNOs on average have set themselves an efficiency challenge of circa 20% over the next five years. In order to achieve this it will require a focus on speed, confidence and quality.

Overall, the electricity industry is undergoing extensive change which is complex and has many interdependencies. The DPCR5 challenge is to balance the current financial and regulatory performance imperatives with future requirements in order to achieve and outperform the current and future regulatory cycles.

## Key industry drivers for consideration

### Cost Efficiency

- Benchmark efficiencies
- Reduce unit costs
- Reduce overheads.

### Regulatory Challenge

- Output measure regime
- Scrutiny through RIGS
- Future Revenue = I+I+O (RIIO)
- Period extending from 5 to 8 years.

### Delivery Challenge

- Doubling of outturn volumes
- Network performance targets.

### Structural Change

- Asset owner - asset operator service provider
- Supply chain response.

### New Technology

- Home automation
- Microgeneration
- Self healing networks.

### Customer Focus

- Customer expectations
- Connections GSOPs.

## Key performance drivers

The capabilities required to outperform DPCR5 and future review periods are also evolving. There are several key performance drivers that when addressed, make up the recipe for success, namely **Asset Management, Programme Management, Contractor Management, Procurement and Organisation Effectiveness.**

At this early stage in the review cycle, the need to unlock shareholder value is paramount. Critically all organisations need to accelerate the speed with which they adjust and push through current performance levels by balancing these key performance drivers. Recognition and speed of change and delivery creates a lean and efficient organisation that is better positioned to respond to future impacts.

Other industrial sectors are doing far more when it comes to improving efficiency. A number of organisations outside the utility sector have explored alternative, lean models that drive out duplication, waste, and deliver efficiencies. The oil and gas and aviation sectors are driving the frontier with 'cost to serve' efficiency levels beyond those that are best in class within the utilities sector. These companies

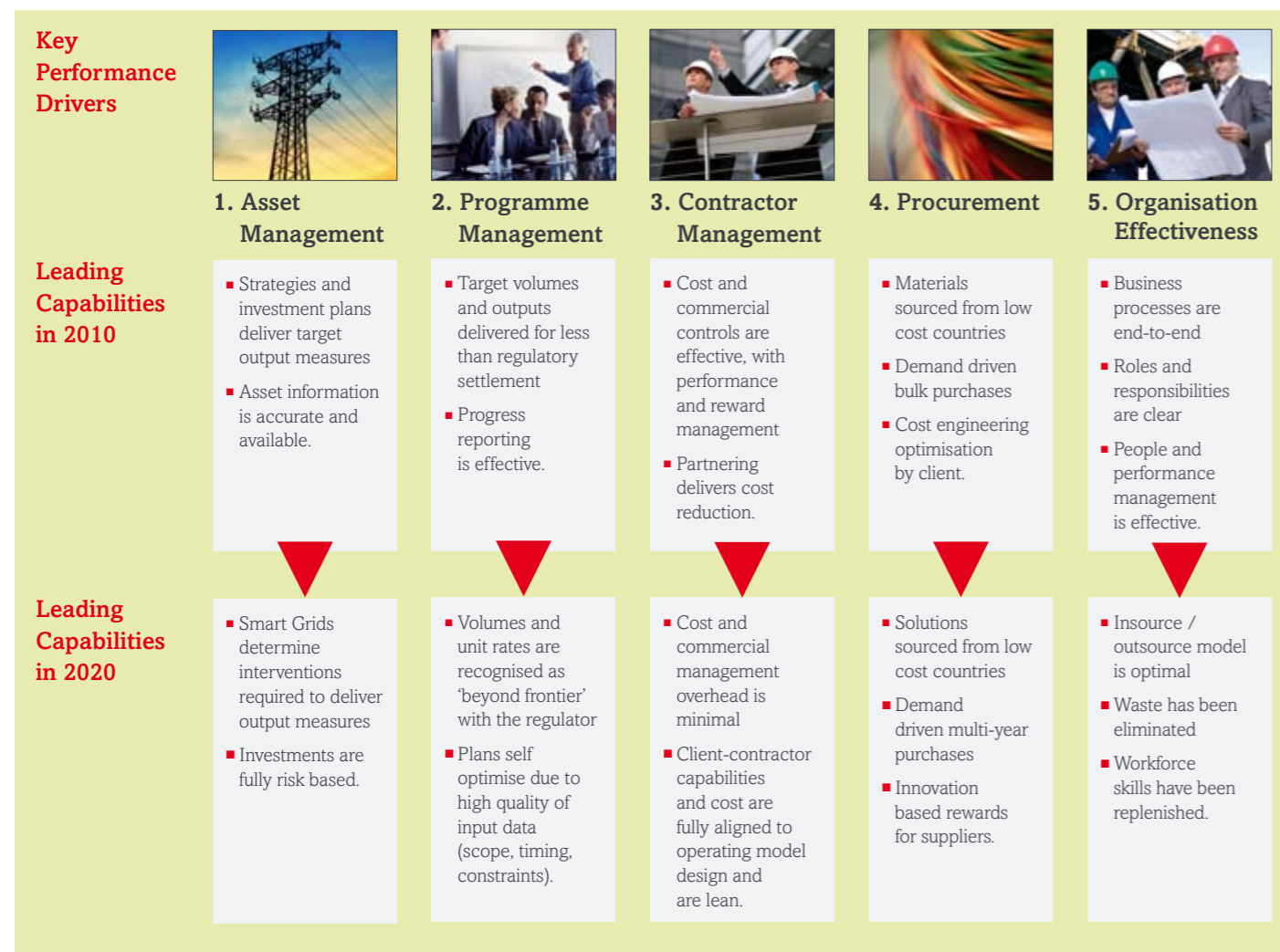
possess models that have integrated programme controls with world-class commercial management capability.

By continually linking key initiatives to outcomes, a culture of long-term commitment to performance management will become embedded within the organisational design. Only then will we see true business transformation and outperformance of DPCR5 settlements.

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# What are the key areas of opportunity to outperform the current and future regulatory cycles?

There are multiple strategic imperatives for success that need to be considered in order to effectively deliver the next five years...



## 1. Effective asset management links investment plans to customer outcomes

Asset management is underpinned by strategies and policies that drive performance. The need to identify what constitutes best in class asset management and both measuring and providing evidence of performance is paramount. Industry evidence would suggest there is a distinct need to do things differently. Piloting of new policies or technology can prove hugely beneficial; by starting small and feeling the results throughout the organisation, success can soon become a self fulfilling prophecy. At the same time it is important to be realistic about the timing for when improvements can be fully realised and recognising people and change dependencies.

A global telecommunications company has had huge success in this area through the introduction of a strategic asset maintenance regime, which optimised asset performance. Benefits were embedded and assured through careful change management and robust governance processes. Several DNO's are seeking to replicate this type of thinking, by revisiting their policies and tools to more effectively manage asset health and network load indices.

How can you facilitate even greater emphasis on linking asset investment plans to customer outcomes? This requires greater understanding of actual asset integrity, and what the optimal intervention is to deliver the required customer outcome for an acceptable level of cost and risk. The availability of accurate

asset information systems to support these decision making processes will be a key enabler for success, as will ensuring the systems are kept up to date by both client and contractor.

Integration lies at the heart of true asset management. This starts with integrated end-to-end processes across the supply chain that align the needs of engineering, finance, regulation, IT, delivery, operations and other stakeholder pressures. These processes should be measured using KPI's that drive performance and target business outcomes, and they should be underpinned by integrated tools and systems (asset registers, work management, finance and reporting), with robust data. Alignment of people and skills is also key to success.

Quality asset management plans are the critical building block in releasing long-term sustainable shareholder value, but frequently the downfall in improving asset management effectiveness is in the failure to link initiatives back to hard outcomes. During the myriad of change, we often find organisations can lose their way, and quite easily overcomplicate or oversimplify for little value.

## 2. Commercially led programme management unlocks shareholder value

Clients across many sectors have deployed programme management for a number of years, typically this has focused on the governance, control processes and procedures required to govern programmes effectively. Recently we have seen increasing demand for a more commercial approach to programme delivery.

Commercially led programme management enables business benefit and cost reduction through transformational restructure of assets, processes, resources and supply chains towards delivery of defined business needs. It is 'commercially led' because those business needs will have a direct impact on share price or stakeholder value.

The current push for increased standardisation of work specifications and project definitions will enable greater flexibility in the operating model and supply chain choice, as project scope, risk, and value for money will become more transparent. Integration of planning, design, estimating, and work delivery tools to utilise common assumptions and data will be required for value to be released.

Frontier performers will build their programmes using consistent methods and definitions. Project cost and commercial controls will be designed to empower the Programme Management Office (PMO) which will have the ability to proactively manage and measure productivity, and track progress. Nevertheless, under-investing in planning and scheduling coupled with silo mentality, too often results in sub-optimal performance.

On the other hand keeping abreast of updated engineering specifications, integrating toolsets such as Primavera, and critically understanding programme linkage to target output measures to drive incentivisation, can be enablers for success.

This should not only be prevalent within individual work programmes, but also linked across differing but interrelated investment programmes. The transparency and visibility of any poorly performing or non-productive elements of delivery allows issues to be identified and incorporated into intelligent profiling to ensure that outturn efficiency is constantly challenged and improved upon.

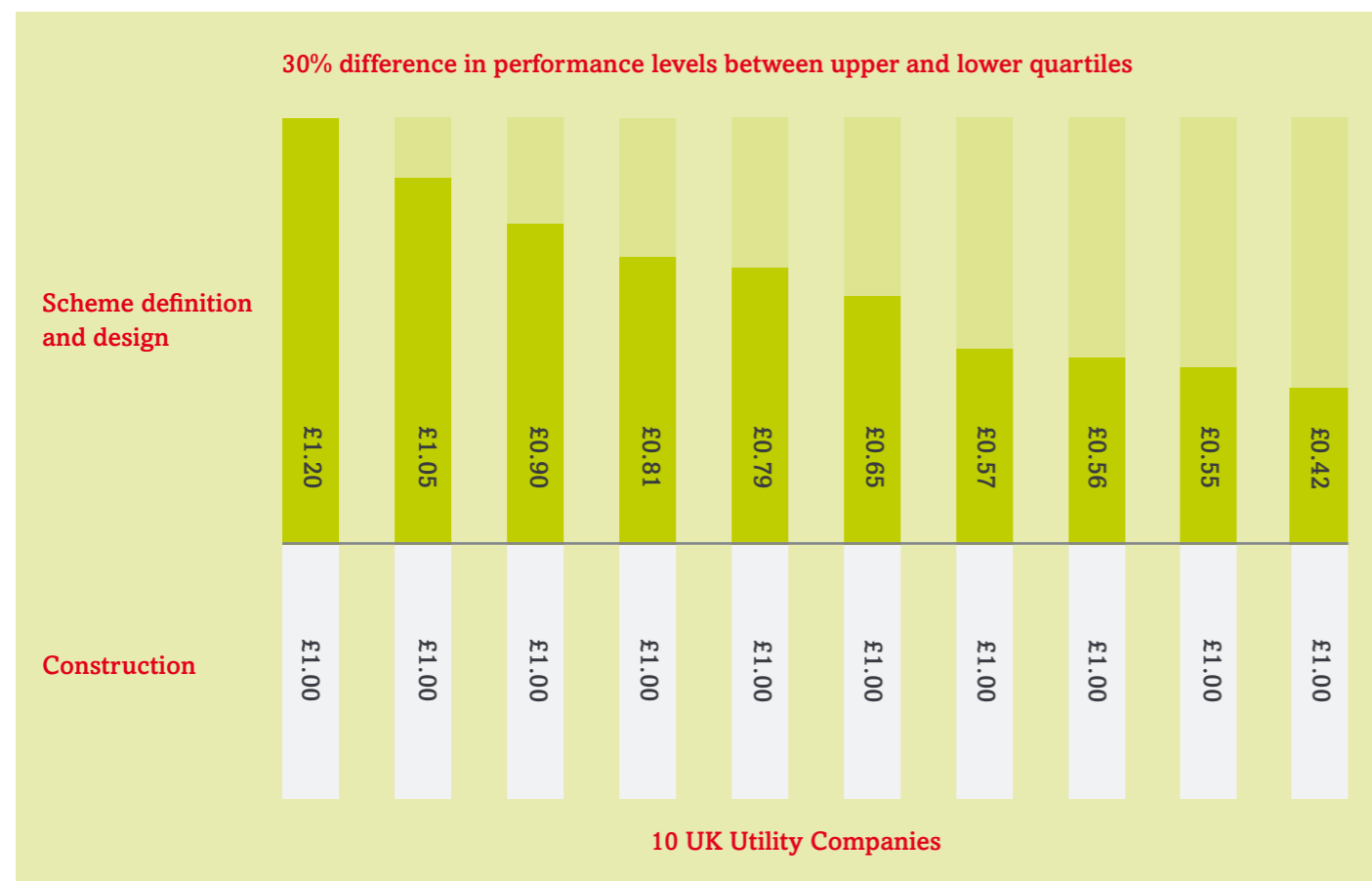
The oil and gas and aviation sectors are driving best in class. Global common estimating systems have been deployed, achieving programme management transparency and control. Generally these companies utilise commercially led programme management business models and are realising:

- Visibility and ownership of the plan by all
- Treasury management - cash utilisation and cash flow
- Projects, programmes and targets aligned to business outcomes
- Challenge to conventional wisdom in delivery e.g. labour productivity
- Standardisation, particularly in design
- Procurement and contracting strategies aligned to performance requirements
- Leverage of scale across the business
- Understanding of the difference between price and cost, which links back into risk and opportunity management
- Maximum efficiencies from an effective supply chain and greater economies of scale.

Commercially led programme management does not reduce the dependency on good management. Quite the opposite, it gives senior managers and business leaders the toolkit to make more informed judgements based on a better understanding of the likely outcome - which is good news for shareholders in times of severe performance challenge.

Recent benchmarking analysis we have undertaken such as our 'Pound in the Ground' comparative study shows there is still some way to go in driving through efficient planning, and driving better performance through a commercially led programme management function in the sector. This is essential to ensure value for money and governance throughout DPCR5, but also to establish and manage appropriate incentives and risk/reward measures across the supply chain for the future.

## What is the ‘Pound in the Ground’ worth in the Utility sector?



### 3. Future proofing relationships drives bottom line performance

Looking forward to 2020 and beyond, the client-contractor relationship should be one where capabilities and cost are fully aligned to the operating model design and the adoption of full lean principles have been realised. Many would argue they are currently operating at this level. If so the cost and commercial management overhead will be minimal, whilst our evidence would suggest that this still seems to be an area of significant overspend today.

Now is the time to begin work on future proofing contractual relationships. This should entail the development of effective alliances with shared incentives and rewards as well as customisation of models for different work types, i.e. connections, major projects and maintenance.

Central Networks, for example, has started this journey and gone beyond the five year regulatory cycle by establishing alliances as vehicles for delivery of infrastructure maintenance and new connections over a 10 year term.

Very clear responsibilities should run across all areas of planning, design and close out with lean and efficient decision making processes. Tolerating poor performance however, whether this is internal or external, will soon undermine progress and potentially reinforce short-termism.

Linking asset data quality assurance to contractual terms will start to shift the way the sector operates and a new approach embedded. At the same time commercial incentives that are aligned to business outcomes, and managed effectively will have the most impact on bottom line performance.

### 4. Alignment of client and supplier objectives delivers real added value

We are all familiar with the concept of supply and demand but more often than not we can become so wrapped up in every day delivery, that the boundaries of who is taking the lead - client or supplier - become blurred. We need to reach a position where DNOs are ‘owning’ their supply chains, are understanding demand and have long-term visibility. This will

allow shaping of the supply chain and crucially the alignment of objectives between client and supplier. Without this we will not see the level of efficiency required and the added value that can be generated.

In the past we have experienced a lack of rewards for suppliers even when they have clearly invested for the clients benefit. Going forward we need to see supplier incentives being aligned to business objectives to drive the right behaviours, culture and performance.

In addition, pooling demand, standardising goods and services and finding the lowest cost source for materials (cost being a combination of price, quality, life cost and innovation) will enable the best possible price to be leveraged across business groups and between them.

### 5. Organisational effectiveness - does an optimum operating model really exist?

To optimise organisational effectiveness it has to come down to the business drivers and burning platform of each and every DNO.

A clear vision and strategy backed up by strong, transparent and inspiring leadership is vital. A breakdown in top down sponsorship will lead to executive misalignment and a lack of commitment to the benefits that can be derived.

Collectively all of the issues addressed so far need to be considered in the context of overall organisational

effectiveness. Core business functions of construction, maintenance, customer connections, and fault / emergency repair need to be delivered within efficient end-to-end processes, where roles and responsibilities are clear across the supply chain. This poses operating model questions in terms of what the optimal insource/outsource structure should be. Attention to detail and using scenarios to test insource/outsource decisions can prove highly valuable.

Implications for people, skills, performance management, and long-term sustainability are significant, and the choice of business operating model will determine where the industry’s best skills end up - will they be with the utility or the contractor? Skills and competency requirements should exist across all key business processes with a clear understanding and managed effectively. Centralisation for common functions to promote consistency can be a quick win if not already achieved.

The foundation for success however, will be not forgetting the people. Essentially they need to buy into the vision, have confidence in the operating model and be part of it. Performance management will be effective when rewarding high performers, not tolerating poor performance, and being seen to do both. Personnel will become motivated and feel proud to work for the organisation, equating to low attrition rates and high productivity for both direct labour and contractors. A long-term commitment to performance management will inevitably become the norm.

## Lean efficient organisations are better positioned to respond to future imperatives

The benefits from transforming utility organisations are delivered across the value chain and range from OPEX savings to CAPEX avoidance. We have found that the activities which support outperformance create an organisation that is ‘fit for the future’.

We believe sustainable positive outcomes can only be achieved through genuine performance transformation across all aspects of the business operating model, and this is what will deliver the step change improvements the industry is seeking now.

This review is not just about the next five years, but also about balancing the expectations of investors and customers in the longer term. Ensuring all the value levers throughout the business are operating at their optimum level will be essential if those expectations are to be met.

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