

# DELIVERING THE NEXT FIVE YEARS - TIME FOR TRANSFORMATIONAL CHANGE?



*“The dust has finally settled following an intense period of negotiation with Ofgem. The time has now come for the Distribution Network Operators to execute their plans to deliver the improved levels of operational efficiency, customer service and an increasing capital expenditure programme; all encased in the strongest regulated regime since privatisation. For some companies this is going to take them into uncharted waters.”* Mark Horsley - Partner, Power Distribution

Ofgem has firmly laid the gauntlet down for companies to deliver efficiency savings from day one, refusing to provide glide paths as used in previous reviews.

In an exceptional period of financial instability, shareholders and investors in regulated utilities are going to demand cost certainty and improved efficiency. Management teams are going to be under the spotlight to ensure they deliver. It is fully recognised that the sector has exceptional engineering skills at its disposal; however, this alone will not be enough to deliver the performance challenge needed.

## Unprecedented times ahead...

Added to this, is a demand for new thinking in terms of new build power network design - incorporating sophistication to address the supply/demand balance, in order to facilitate the implementation of smart grid technology and the connection of significant distributed generation both on

and offshore. These are unprecedented times for the industry, with a great deal of the future success for a low carbon UK economy relying on the energy infrastructure being planned and built today.

So in every sense, one pound lost to inefficiency, is a pound lost of opportunity for both investors and customers.

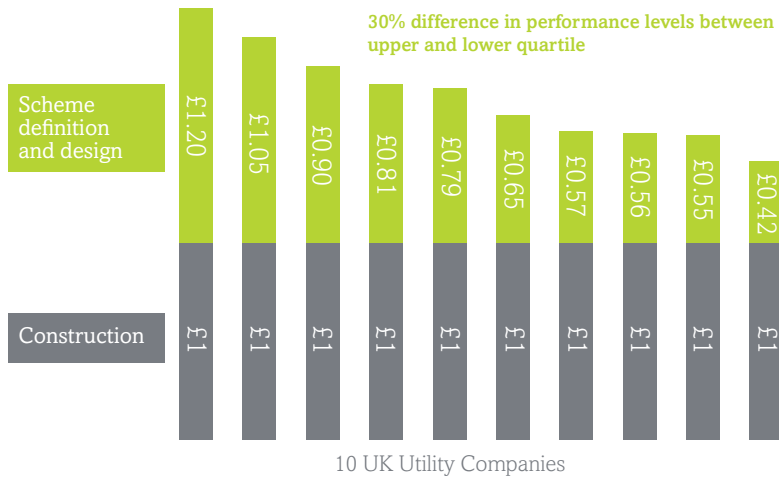
## Delivering improved efficiency

Over the past twenty years the sector has made huge step changes in improving efficiency; and is almost unrecognisable to the one we worked in prior to privatisation. The real question is: ‘can we make the next step change purely through the tried and tested techniques of resource rationalisation and supplier price reduction?’ Now is the time to reconsider - what are the potential solutions and what are the key factors to ensure they succeed.

### Up to 30% difference in performance

Work undertaken by EC Harris estimates there is up to 30% difference between upper quartile and lower quartile performance on capital delivery in the utility sector as demonstrated in the '£ in the Ground Analysis'. Figure 1 illustrates the spread across 10 UK utility companies each with major capital delivery programmes.

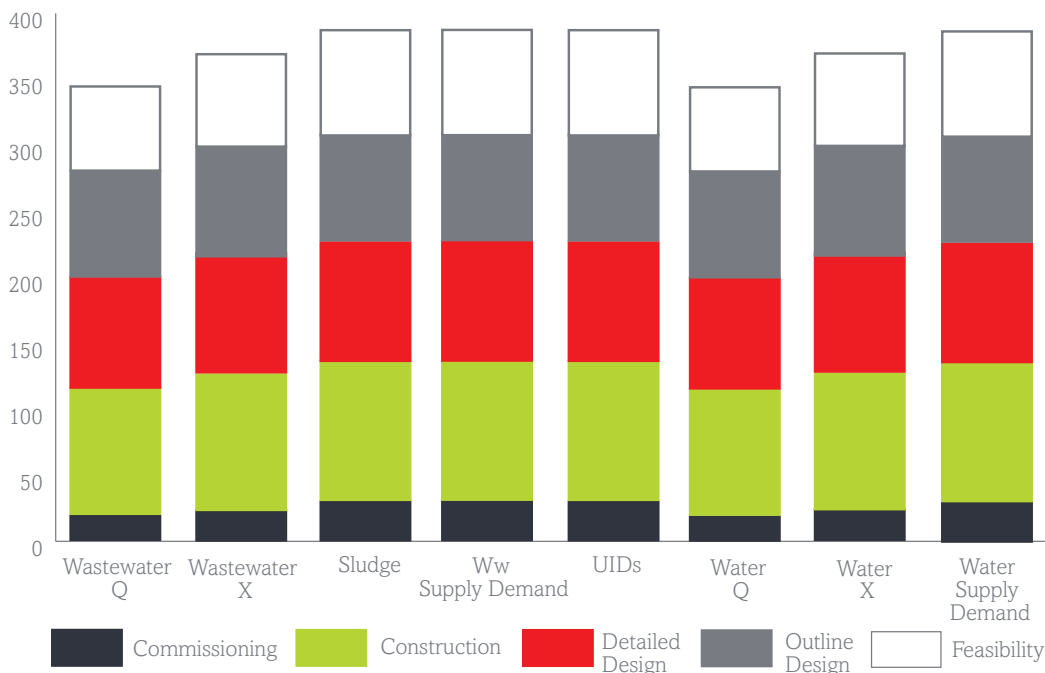
**Figure 1. What is the pound in the ground worth in the utility sector?**



### Cost to serve - how are you performing?

Further detailed analysis of the data indicates two thirds of the demand to build cycle is spent in feasibility and design. The potential to decrease costs significantly at the pre-build/commissioning stage of the project is demonstrated in Figure 2. This insight has led to a number of organisations outside the utility sector to explore alternative, lean models that drive out duplication, waste and deliver efficiencies in these processes. 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 utilise commercially led programme management business models that have integrated programme controls with world-class commercial management capability.

**Figure 2. Two thirds of the end-to-end capital cycle time is spent in feasibility and design**  
Implementation Durations (example work £0.25 million)



*“Some companies have developed alliance frameworks to deliver increasing capital programmes; which executed correctly through commercially led programme management can provide significant savings through the removal of duplication and alignment of strategy between the client and supplier.”*

### Transforming the business model

There is a need in the utilities sector for a more fundamental review of operating models and processes, reinforcing the point that supplier price reduction and concentration of on site delivery efficiency in isolation, will not deliver the required step change. Over the past twenty years a number of strategies have been put into play, from totally outsourced models, to forming strategic alliances, and companies that undertake the majority of service provision themselves. As with all business models there are positives and negatives; it also has to be said, there is no ‘silver bullet solution’.

New business models will need to be implemented quickly if they are to impact the full review period. A number of companies have already undertaken business process reviews in anticipation of the review outcome.

### The creation of a commercial entity will enable best in class delivery of expenditure programmes

It is essential that there is a commercial framework at the heart of these models in order to add rigour and justify engineering decisions and processes. This equally applies to the customer facing parts of the organisations, such as new connections and fault management.

Some companies have developed alliance frameworks to deliver increasing capital programmes; which executed correctly through commercially led programme management can provide significant savings through the removal of duplication and alignment of strategy between the client and supplier. Again, we have found in a broad range of sectors, that one of the key underlying success factors has been the creation of a commercial entity for the client to strengthen the in-house engineering project management expertise and cost delivery certainty.

### Cost certainty across the asset life cycle

The one common theme that pervades the whole sector is the absolute requirement to deliver cost certainty in all activities, across the asset life cycle. This means having accurate cost data and robust cost control processes in place throughout the value chain.

When an investment decision is made and funding is secured, in either capital or operational activities, it should then be delivered for that amount; and there should be gating processes throughout the programme delivery journey to confirm that is the case. The timings and interventions will be driven by the nature of the work.

Detailed analysis of the design and feasibility processes also suggests that leading edge companies have in place:

- Clear decision gateways to evaluate options against the initial business case
- Alignment with the overall asset performance improvement plan
- Clear programme and project level governance, enabling right first time
- Robust asset performance and commercial imperatives.

### Shaping the future workforce

The sector is heading toward a resourcing cliff edge, with workforce renewal required both within the companies and their service provider community. The sector needs to ensure it has the skills and capability needed to deliver the cost certainty its owners and shareholders require.

This renewal will provide the opportunity for businesses to shape their future operating models and supply chain strategies for the next generation. The re-shaped models will need to assess their needs in terms of achieving a balance between engineering and commercial expertise, which can embrace and drive change throughout the operation.

### Maximise the output

Utility sector analysis also suggests that in certain cases companies who have opted for an outsource option to undertake a large proportion of their capital programme, either through alliances or more traditional schedule of rates, have failed to fully address the existing internal resource utilisation. Therefore in effect, creating an increase in indirect costs or an under utilisation of direct labour. The successful exponents of outsourcing models have carried out detailed capacity/capability planning in advance, and have defined a delivery strategy that maximises the output from their internal resources.

*“So in every sense, one pound lost to inefficiency, is a pound lost of opportunity for both investors and customers.”*

### In summary

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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