

# Performance management helps merging utilities hit value targets

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As the electric utility industry moves into a more competitive market, the pressures applied by shareholders, regulators, and customers are escalating. Some early predictions by firms such as McKinsey & Co. argue that, in the United States, \$45 billion in pretax earnings would come into existence if transmission and distribution (T&D) were brought up to best practice levels. A recent study by JD Power & Associates suggests similar opportunity to improve customer satisfaction levels.

The vast majority of U.S. utilities are coming up short on both fronts. Though utilities have responded to these pressures with bold promises about plans to create value for stakeholders, the harsh reality is the bulk of this value never materializes. Michael Hammer's assertion that "...75 percent of reengineering projects fail to deliver the results they promise..." suggests much investment in improvement never generates a payback. Utilities have been slow to release value they know is there—largely because they can't see it.

Particularly relevant are the promises made to shareholders and regulators during the period before merger approvals. Our research shows, against average 10 to 20 percent "synergy gains" utilities promise during the merger approval process, the realization rate is less than one-third.

Mediocre performance by so many utilities stems from their inability to discover where value resides, how best to access it, and how and when to release it. This is crucial, because companies who have mastered this not only deliver on the commitments they make, but often are able to take on

much bolder market targets than their competitors can.

## Performance measurement basics

As utility management teams design and launch growth strategies, it is easy to lose sight of fundamentals. Overlooking these fundamentals usually prevents companies from accessing and releasing the greatest value in their businesses.

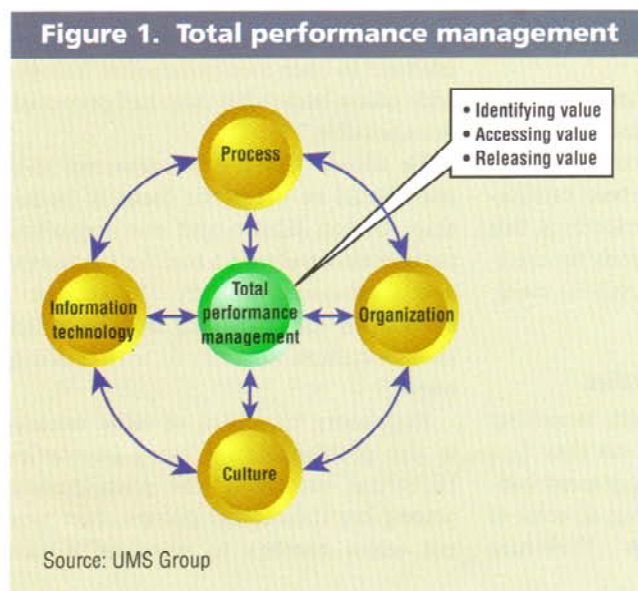
Sam Eddins of HOLT Value Associates, a Chicago firm that provides advice to portfolio managers, said, "Often, the biggest weakness in today's growth strategies is management's failure to understand the fundamental performance of the core business before any decision to merge. It's amazing how many businesses who initiate growth strategies haven't put their own house in order first." Most important is that organizations have the right tools to identify value, and viable plans to release it (see Figure 1).

Many overseas utilities are following this advice closely. In 1997, Hyder Utilities Plc, a large electricity and water distribution business servicing more than two million customers in Wales, initiated a major transformation in their business as part of their multi-utility shareholder value extraction strategy. For Hyder Utilities, understanding internal performance was a critical first step in designing and implementing this transformation.

John Roberts, CEO of Hyder Utilities, said, "IT, organization, culture and process are all key building blocks in our strategy, but it was our ability to first see where value was located that enabled us to act quickly in areas offering maximum value." At the onset of its change initiative, Hyder Utilities used a comprehensive benchmarking process to identify where value resided in each of its processes, then used the data to plan and stage enterprise-wide improvement initiatives prior to launching its growth strategy.

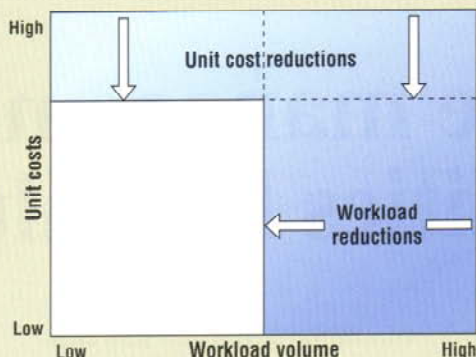
"This industry's inability to release value is largely because we have limited our search," said Stewart Ramsay, UMS Group's vice president of energy delivery. "As an industry, we're seeing the tip of the iceberg, or less. We often find the opportunity set in the average utility to be more than 40 percent of operations and maintenance cost alone."

Most cost lies beneath the surface, where management can't see it. "In operations, we focus on improving productivity,"



**Figure 2. Identification of gap-closing strategies**

- **What work we do (Workload)**
  - Current task volume in each area
  - Asset management policies and standards
  - Discretionary workload in A&G/Corporate Services
- **How we get the work done (Unit costs)**
  - Productivity enhancement
  - Technology/automation
  - Salary/benefit structures
  - Material cost



Source: UMS Group

said Ramsay, “but productivity is only part of performance improvement. Companies often miss the value hiding in their existing workload. They fail to ask: what company really performs best—one who is low-cost at everything, or one who finds ways to do fewer things most efficiently?” (see Figure 2).

Internationally, numerous companies are now seriously questioning the core roots of their costs. Examples include companies that are moving from monthly to bimonthly, or even annual meter reading, particularly for customers already on direct debit and leveled payment plans. For a two-million-customer utility, this change alone could capture well over \$10 million in recurring annual cost—more than twice as much as improving the current workload to best practice levels. The same principles of optimizing workload apply equally well in operations, preventive maintenance and system refurbishment.

With the right asset management practices, such changes can also result in increases, rather than decreases in service levels. Although utilities have been relatively slow to address workload reductions, this area offers significant opportunity for creating and releasing value, especially in merger situations.

### Accessing and releasing value

While finding value is difficult, launching the implementation plan is no easy task either. David Scolah, a management consultant in the U.K. and previous director of network operations with Yorkshire

Electricity Group, has completed extensive business transformation work with U.K. utilities. He said, “A lot of roadblocks can get in the way. Labor unions, internal culture and regulatory hurdles are the big three. Any of these can derail the most robust value creation plans.”

Companies have learned the tools that help find hidden value can also help break down barriers to change. For example, Boston Edison used its benchmarking and performance measurement information as a key tool in shaping labor relations strategy. Ron Ledgett, Boston Edison executive vice president, said, “Our strategy is open communication. We share all benchmarking and performance information with the union, and help them understand the magnitude of the changes. The enormity of the challenges and the willingness to share information enabled Boston Edison’s management to open more productive dialogue with union leadership than had previously been possible.”

He added, “Culture is a powerful lever and should be the prime focus of leadership. Boston Edison and our consulting partner co-developed a tool for measuring and diagnosing culture. It creates a framework for managing actions which change culture to better fit with business needs.”

Regulatory treatment of value released is also problematic for many companies. Historical precedent and misalignment among key stakeholder groups often present major barriers to adoption of new,

more rational regulatory models. The resulting uncertainty and lack of clear incentives paralyzed many management teams from taking bold action. A sea change is happening today, however, prompting many industry leaders to move aggressively to capture and release value, even in advance of new regulatory rules.

Wringing value out of the business now is an important defensive play in the acquisition game. The skills built, lessons learned, and regulatory credibility earned are excellent conditioning for leadership teams when it’s their turn to go on the offensive.

Most utility leaders believe the industry faces several more waves of restructuring and reform. The winners will help set the climate for eventual policy making by legislators and regulators. Doing this will require a different focus on performance management fundamentals, including the following:

- **Adopting benchmarking** and performance assessment tools to help management understand the total value potential in the core business before launching aggressive growth initiatives;
- **Making strategic choices** that openly challenge work practices and strategies, both historical and contemporary;
- **Embracing well designed**, carefully thought-out approaches to implementation that address forthrightly any barriers to success; and
- **Implementing a deliberate** strategy for value release that measures progress, holds business unit leaders accountable, and ensures maximum value is realized and channeled appropriately.

With \$45 billion on the table, and the massive wave of acquisitions coming in the next year-and-a-half, there are enormous payoffs for the T&D companies who understand, and base their business development strategies on, the fundamentals of value creation. ■

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