Future Strategies, Future Procurement Options

A white paper on the future of business process outsourcing in the utilities sector

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VERTEX

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Vertex – An Overview

Vertex is the UK's leading outsourced customer management company. It is the UK's second largest provider of business process outsourcing services* in the utilities, financial, public and private sectors across the UK and North America.
*Ovum, 2006

Vertex was ranked as the number one energy and utility outsourcing provider in the Black Book of Outsourcing's Top 50 best managed global outsourcing vendors' report for 2006. The company's current client portfolio within utilities includes Hydro One, Ni-Source and Duke Energy in North America, and United Utilities and Scottish Power in the UK.

Vertex was acquired from United Utilities in 2007 by a consortium of three US based investment firms – Oak Hill Capital Partners, GenNx360 Capital Partners and Knox Lawrence International. It is now embarking on a significant programme of investment to develop its market share of the UK and North American utilities markets.

Introduction

Organisations everywhere - including utilities - are on a journey. All journeys should focus on change and improvement, as well as an acceptance that whatever is done today must be done better tomorrow.

This white paper focuses on current trends in the development of utilities and to what extent business process outsourcing, underpinned and enabled by IT, will impact on future change.

Vertex's views are based on its long-established experience of working with UK based utilities. The UK model of independently regulated, liberalised markets is one that governments and industries across the rest of Europe and around the world have studied closely and now use as a blueprint for their own transformation programmes.

Core Factors Are Driving Change – In The UK And Across Europe

A number of factors are driving change in utility markets. At the highest level, the European Union and its member state governments are focusing on the key strategic issues of security of supply and safeguarding the environment. Put simply, they want to make sure that consumers will continue to be able to access power and water supplies at a reasonable cost and increasing quality while simultaneously making a diminishing impact on the planet.

Governments are increasingly expecting utility organisations to play an active role in making sure that these key priorities are achieved. As the EU continues to roll out further legislation to make this happen – and, as is happening in the UK, regulators are taking a longer term, more holistic view of performance – it seems that all utilities across the continent will have to improve to stay in touch with the changes that are being demanded.

Consumers And Technology Are Key

Vertex believes that the consumer is a key catalyst for change across utilities markets. The industry has witnessed the growth in both the demands and sophistication of consumers, and this is directly impacting not only on how utilities are re-prioritising strategies and investment decisions, but also on how governments and regulators are taking customers into account when setting the framework for the competitive operational environment.

Consumers are quick learners. They recognise and understand global issues. They can access the Internet and see what is happening elsewhere – in terms of price, environmental impacts and the quality of service. They can put pressure on legislators to make change happen in their own back yard. It is Vertex's contention that future improvements in the performance of utilities will be increasingly driven by consumer pressure.

Clearly, technology will play an important role in future change. Quite simply, there is less and less excuse for utilities not to deliver more consumer-focused efficiencies through IT change. While many organisations continue to rely on platforms and applications that are almost 35 years old, others are grasping the opportunity to migrate onto new systems that transform not only their own business efficiency, but also the customer experience for consumers.

The Overseas Dimension

Offshoring is also having an increasing impact on the changing face of the utilities sector. As a business that has owned and operated two large customer management centres in Delhi since 2002, Vertex is aware of the challenges as well as the opportunities that confront organisations seeking to blend the economic advantages of offshoring with the absolute priority of safeguarding positive customer relationships.

While some utilities have been through some arguably difficult episodes in this area, a form of best practice is beginning to emerge in offshoring. Increasingly, key front-end functions are being sourced from the utility's home market, with a greater volume of back office processes done offshore - quickly and cost efficiently.

New People, New Ownership, New Futures

Change is also happening within the personnel of utilities. Certainly within the UK, the retirement of a generation of managers and support staff in a relatively short space of time is creating a knowledge vacuum within some organisations. And while this presents a significant problem for the utilities this affects, it could, of course, also be seen as an opportunity to bring in fresh thinking and a fresh direction for the future.

New patterns of ownership within liberalised markets are changing the way in which utilities are looking at the world. The acquisition of organisations by equity funds means that the focus on performance is sharpened. This is ensuring that the business maximises its performance to create the conditions that will drive return on investment.

So, what conclusions are utilities drawing about the future? Part of the answer is that organisations are asking themselves some vitally important questions.

These questions can be phrased as follows:

- What are our priority outcomes? What will our future ideal operating scenario look like – and how big is our journey of change going to be?
- What should our core operations be that are going to help us get there?
- What shape of organisation do we need to arrive at this future operating scenario?
- How are we actually going to get things done – and with whom?

There is increasing evidence emerging that utilities are finding new ways of answering these questions. Business process outsourcing, particularly when underpinned by innovative technology solutions, is providing a significant and helpful part of this new way forward. Moreover, utilities are increasingly prioritising better customer management as a core to their longer-term development.

Within some sectors, such as the UK water industry, this in itself represents something of a shift in emphasis. Until recently the regulatory environment was focused on efficient asset management, but this has now moved to focus more on customer-centric end-to-end process improvements. Accordingly, Water UK can now point to a consumer policy workstream that prioritises customer needs, with business processes aligned to enable utilities to deliver improvements.

Clearly, in a liberalised environment, profitability within the context of regulatory supervision will also be an on-going focus, but the real challenge here is to make earnings the by-product of a sustainably successful and productive utility – and not a short-term goal in itself.

Getting The Balance Right

It is clear that how a utility goes about answering these questions will help to define the future shape of the utility. For example, if an organisation believes that the efficient management of its assets is key, then it is likely that the business will employ a lot of engineers, and perhaps fewer marketing people. Make consumers a more important element of your future business and this balance is likely to shift – and the rapid growth of investment by utilities into customer segmentation analytics and data mining to retain and cross-sell products and services to consumers is perhaps the most recent obvious trend in this direction. It is also the case that competition is growing in the sector, as more and more retailers and banks begin to offer 'white label' utility products. Two of the UK's largest supermarket chains – Tesco and Sainsbury's – the latter through a partnership with EDF - offer branded energy products, and they have very recently been joined by Asda Wal-Mart in the same market space.

Vertex would argue that it is relatively easy to analyse the behaviours of UK-based utilities in recent years to draw some conclusions about the way in which the sector is attempting to answer all these challenges for itself.

The majority of players initially attacked easy cost wins to boost efficiency and profitability – but it is true to say that this can only ever be a relatively short-term tactic, because quick wins tend to dry up rather rapidly.

There then followed a fairly frenetic period of mergers and acquisitions in the UK. This hasn't just been about investors seeking to secure profitable growth. The recent approval by the Competition Commission of the merger of South East Water and Mid Kent Water represents a good case in point. The fact these companies were able to prove that the merger was good for customers as well as investors was one of the key factors that underpinned this approval.

This period of mergers and acquisitions has also been about attempting to achieve real scale and capability – indeed, a recent KPMG study has identified the European Union as a future breeding ground for utility super giants. Additionally, businesses have also sought to acquire non-regulated operations that can help both maximise and lock in customers as well as delivering additional revenue and margin streams. The more recent trend that has also seen disposals of non-core activities highlights, perhaps, a fluidity of decision making as companies continue to develop and re-align their strategies.

When considering the issue of organisational shape, it is possible to see a wide spectrum of response in the industry. There are those utilities that continue to centrally manage the majority of their assets and functions, right across to business models like Welsh Water/Glas Cymru. As a single purpose company with no shareholders, Glas Cymru's focus is on reducing Welsh Water's asset financing cost and improving service delivery levels by employing best in class contract partners for each distinct activity of the business.

Alternative Business Process Outsourcing Models

Such a range of response underlines the fact that there are a number of BPO models that a utility can consider when it is deciding on its best strategic response to the challenges it faces. Vertex believes that there are five distinctive BPO models from which utilities can choose.

The first model sees an organisation that wishes to retain control across all of its business processes, but decides to bring in, for a defined period of time, outside expertise to improve the performance of a specific function. In this scenario, the organisation can decide whether it wants to define closed objectives, such as "improve my call centre so calls are answered within 10 rings", or open objectives, such as "improve my call centre to uplift customer satisfaction by 20%". This is, regardless of the objectives, a model that builds or transforms a workstream, operates it, then returns it to the client. From a client's point of view, this model means that they retain overall control over the function, but there is inevitably less transformational impact across the organisation, and there could also be question marks over its sustainability once the BPO team has returned the process.

The second model extends the scenario of model one, in which an organisation retains control over the majority of its business functions but chooses to outsource a specific process on an on-going basis. The organisation still possesses the option of setting open or closed objectives, but sees the outsourcer as part of an overall strategy. At this point, a commercial interface is created between the two businesses to manage contracts and service levels. This model is important where getting the key steps of transition and integration of the function into the outsourcer's business is critical to the long-term success of the initiative.

The third model fits situations where an organisation recognises that there is a range of operations that it would rather have done by other specialists, and it creates more complex service level and cost agreements to achieve its ambitions. This is commonly described as 'end-to-end' BPO, although it's often the case that organisations cherry pick tasks to outsource; for example, in outsourcing customer management, an organisation may choose to outsource call centres and billings, but might not outsource, say, face-to-face customer representatives, or the complaints department, or similar. It's an arrangement that builds on the strategic philosophy of the second model, and is likely to have a broader impact on organisational transformation.

The fourth model sees an organisation outsource a range of functions by selecting a network of 'best of breed' partners. In this scenario, organisations work harder to ensure that they can manage the complexity of contractual relationships that are needed to sustain a multiple partner approach – but it can be worthwhile where an organisation is seeking to make a co-ordinated and significant impact on its key performance measures.

And finally, the fifth model continues to see an organisation outsource multiple functions to best of breed suppliers, but puts in place what is effectively a supply chain head to manage the relationships and contractual complexities and take responsibility for the broader solution.

New Philosophies In Procurement

So, it is clear that there are a variety of views about what should be the best way to be successful as a utility in today's operating environment. But how does this help answer the question "what's the best way of getting things done here – and who should we work with to get us there?" In Vertex's experience, the traditional approach to procurement is still alive and well within many utilities. Their position is actively linked to their desire to control the majority of functions within their organisation. Suppliers are regarded as just that – to be seen as outsiders who should tender for contracts and qualify merely on the basis of lowest cost for any given level of desired product or service quality.

Nevertheless, times are changing, and more and more utilities businesses are putting in place increasingly sophisticated procurement approaches. In particular, utilities are beginning to adopt strategies where a prime partner is appointed to manage and co-ordinate the activities of a supply chain to ensure service quality is achieved. The prime partnering model of procurement is one that is well established in an increasing number of industries round the world, in which a relatively small number of partners head up the supply chains of their client's key operational activities, enabling the business at the centre to concentrate on customer-centric strategic development priorities.

Within the utilities space, prime partnering has tended to be shaped around what could be termed a service integrator model. In other words, the prime partner agrees to deliver what their customer wants, and makes sure that it channels its efforts and the efforts of its own specialist partners in its supply chain to meet the expectations of the client. That's fine as it goes, but a service integrator relationship is still likely to be secured with a myriad of complex service level agreements and contractual reassurances. It is also probably the case that the contract shape is very much one-way traffic, with the utility setting the benchmarks and managing the overall terms of what the relationship should be achieving.

What's encouraging is that this prime partner approach is in itself evolving, as utilities begin to better understand how far they can take these relationships. Some utilities are recognising that there could be more to be gained from allowing their prime partners to play a more active and mature role in shaping the direction of their relationship. This is a shift from the often passive and reactive service integrator model to one that Vertex would term a solutions integrator model, in which the prime partner is able to challenge their client to say – "actually, we know plenty about you and your industry and we can help you to better define where you should be heading and how you're going to get there. Once we've agreed all those things, you can rely on us to go away and come back to you with a gameplan on how we're going to help you get there."

This maturity of approach should also extend to the way in which the contractual agreement between both partners is structured. Best practice here stems from accepting the concept of risk and reward, and less, perhaps, on multiple service level agreements. That way, it then becomes in the prime partner's best interests to really pull best-of-breed services through its supply chain, and focus on consistently over-delivering against client expectations. It might sound a bit of a cliché but risk-reward in this context should all be about win-win.

Solutions Integration – A Viable Strategy For The Future

As a business, Vertex has active experience of working with clients as a solutions integrator. For example, the company partners with United Utilities to help it re-shape its information technology strategy. This process began with delivery of alto, an open platform customer-centric billing and cash management application designed specifically for the utilities sector. Vertex then took ownership of the responsibility for delivering a comprehensive consolidation programme to give United Utilities the capability to achieve a series of jointly agreed objectives. Vertex's task isn't just about making this aggregated information solution process operate effectively and efficiency; it also means that Vertex helps shape how United Utilities' IT strategy needs to anticipate future business needs and priorities in the years ahead.

Vertex also possesses an unmatched reputation working as a solutions integrator to help clients transform their broader business processes. Within local government in the UK for example, Vertex has played a key role in helping high profile clients such as Westminster City Council undertake large-scale strategic steps to review, revise, then re-engage with residents, businesses and visitors. The result? A broader range of better quality services and a significant and sustained improvement in levels of positive customer feedback – all achieved while delivering absolute reductions in cost-to-serve.

These solutions integrator led successes have come about through taking a shared approach to agreeing what the priority outcomes will look like, then putting together an effective operating strategy to make sure that these outcomes are actually achieved. But it is not just about being strong in planning and strategy. It is also about being able to deliver results and being measurable and accountable for our actions.

Vertex doesn't stop with the strategy, which is how many within the management consultancy space prefer to operate. Instead, the company's employees see themselves primarily as practitioners – which means working on the ground alongside clients to make the plan happen. In this, Vertex's heritage in the utilities sector is a strong advantage; the company's teams understand the issues that make utilities unique – and also possess a strong grasp of what's needed to make real progress in helping organisations within the sector to succeed.

Leadership – A Vital Dimension

Leadership is also a critically important factor in managing change within the utilities sector. In an environment of more consumer sophistication, evolving regulatory pressures, the growing likelihood of competition, and the twin challenges posed by national and EU legislation, the need for increasingly high standards of leadership within utilities will be a key priority for the future.

This is particularly true when it comes to clarity of vision and purpose about how the organisation will be shaped and how it will outsource key processes. It is vital that the utility understands and communicates its strategy and the operational consequences of its decision-making clearly and consistently. It is this emphasis on clarity that should be focused on when it comes to considering best practice in business process outsourcing within the utilities sector.

It is Vertex's view that the real challenge for utility leaders both now and in the future will be for them to develop the way in which they effectively contract with business partners. This is true whether or not a utility wishes to go down the road of service or solution integrator, or merely wants to improve the way in which it engages suppliers for key performance areas within its business operation.

There are a number of areas in which this thinking can be focused. Utilities should work hard to make sure that they have a clear idea about what it is they want to achieve from working with partners and why this is for them the best solution. They should then engage openly with prospective partners, and develop and maintain open procurement procedures. There needs to be a recognition that partners should be allowed to make a margin on the solutions that they bring to the table. The truth is that a partner's profitability provides tangible evidence of joint success – and it highlights how the sharing of risk and gain can form a key element within BPO agreements that benefits both parties. There should be a strong focus on governance, so that both the utility and the partner put a significant amount of effort into building and sustaining relationships.

And, for those utilities that are seeking to build a prime partner approach to managing their supply chains, there should also be a recognition they share a responsibility to manage and nurture the relationship so that there is continuous investment in the partnership and a joint commitment to manage governance issues going forward.

Customer Satisfaction – The Real Driver For Change

So what conclusions can we draw about the future direction of business process outsourcing within the European utilities in the years ahead?

It is Vertex's experience and belief that it is customer satisfaction that is driving change in the energy sector. Customers now have the ability to change their suppliers easily, and the two key drivers of satisfaction are price and service. Whilst this has been especially true within the power markets, it is an emerging priority for water businesses too. We can see consumer feedback shaping priorities on asset planning and management, and we can also see it influencing the development of relationships and dialogues with regulators. In many ways, the customer management journey that Vertex clients within other markets have experienced is becoming increasingly relevant for operators within the utilities sectors.

Complementary Talents

KPMG has already referred to the likely emergence of utility super giants across Europe. It is possible that this phenomenon will be mirrored by a growth in large prime partners as more utilities begin to recognise the benefits of outsourcing at this strategic level. After all, the areas in which utilities and BPO businesses tend to specialise are almost perfectly complementary. The core skills of utilities tend to lie in the area of large-scale project management, big asset and capital-intensive operations, funding and finance excellence, regulatory relationship management, and long-lived assets. BPO players, in contrast, focus their expertise in areas that include people intensive processes, the management of rapidly depreciating assets with continually changing technology, the transfer of expertise across industries, and the exploitation of technology-intensive efforts across industries. BPO players should be able to offer utilities not only deep knowledge and delivery ability within these areas, but also, crucially, significant scale economies for cost reduction and scale capabilities for asset sharing.

These services can assist larger utilities seeking focus in a period of growth and support smaller utilities looking to reduce any disadvantages of smaller scale. Large scale BPO partners are likely to have significant business interests in other marketplaces, which means that they will be able to offer new solutions and import best commercial practice into their utilities clients' operations. In a space within which in-house expertise is becoming a scarcer commodity, these factors will add increasing weight to the value of more sophisticated BPO relationships.

There is, of course, a belief that utilities industries are cautious, and some players are reluctant to go beyond build-operate-transfer or operation and maintenance contracts. Vertex's response to this caution is to work with clients across a broad range of contractual arrangements, but also to encourage them to understand that other engagement models are open to them and could be worth exploring.

Towards The Future

Despite this reluctance, times are changing. There is a growing recognition that the complex and often competing priorities of consumers, governments, regulators and shareholders cannot be easily met doing business in the way that it has always been done. With a new generation of management coming into the industry, there will be an increasing level of enthusiasm to continue to develop new business process outsourcing solutions that make sense and meet stakeholder needs more completely and more consistently.

This is especially true for the technology agenda within European utilities. There are many emerging issues that are now competing for space within a technology decision maker's in-box, including the impact of corporate social responsibility on regulatory compliance, knowledge management, developing the workplace for the next generation of digitally sophisticated employees, the consumerised web 2.0 environment, the increased importance of flexible working balanced against traditional management structures, and how Software As A Service might change the sourcing landscape – to name but a few.

In conclusion, there are many emerging themes that need to be debated. Vertex is ready and committed to work with people and organisations that are enthusiastic about the future to explore different strategies as utilities meet the challenge of change.

Vertex, Pegasus House, Kings Business Park, Liverpool Road, Prescot, L34 1PJ
www.vertexgroup.com

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