

A GUIDE TO TRANSFORMING PROCUREMENT WITHIN UTILITIES



An Insight Whitepaper

Jonathan O'Brien | CEO
Positive Purchasing Limited

Christine Lithgow Smith | Founder
Chrisalyst Limited

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August 2018

Procurement Transformation

Worldwide, the utility sector generates over \$3,500 bn¹ in revenues and is an industry that has been forced to change hugely and rapidly. As utility companies step up to meet the challenges they face amid waves of fresh change, procurement within this sector has been slow to catch up and play its strategic role. Leading procurement expert Jonathan O'Brien and transformation specialist Christine Lithgow Smith explore what lies behind this lack of movement, and set out exactly what utility companies must do if procurement is to make a strategic contribution to the success of the organization.

Whilst the all-encompassing label 'utilities' describes a range of different types of service provision, it also covers a range of different types of companies operating in a variety of regulatory and legislative environments. They do, however, all have something in common: they exist and operate in a fast-changing external environment, and most are still grappling with a range of legacy internal challenges.

Utility companies that once just had to 'be' must now be efficient and effective, and perhaps also compete, in order to secure their future prosperity and even survival. Where utilities procurement functions once 'bought things', the future utility businesses demand a new type of procurement, and one that is playing a key role in enabling the success of the organization. Realizing this depends upon the ability of the utility company to transform its procurement approach and overcome a variety of factors unique to this sector.

WHY IS TRANSFORMING PROCUREMENT SO DIFFICULT IN UTILITIES?

Utilities operate in an increasingly complex environment that continuously affects strategic decision making. They are at the mercy of many external factors beyond their control, perhaps more than any other sector. Depending on the segment of the industry in which an organization operates, it is likely to carry the legacy of privatization and

may remain heavily regulated. Within the UK, for example, a degree of competition has emerged, but consumers must still buy domestic water from a single provider.

Across Europe, the degree of regulation varies; some countries are a long way down this road, others just starting out. We saw the US market open significantly after The Energy Policy Act called for greater energy efficiency in 1992, but there is still only partial deregulation which varies enormously by state² and, like the UK, a natural monopoly prevails for energy network operators who sell access to their networks. In general, privatization has led to increased competition, with new entrants to the market and new business models being created across geographies, enabling consumers to switch providers and ensure value for money for themselves. Despite this, in an industry offering public services and still subject to regulation, scrutiny over price remains and governments are not afraid to intervene, as demonstrated by the Domestic Gas and Electricity (Tariff Cap) Act in the UK, hence a change in political party and/or policy can have long standing consequences.

There is also an increasing call for environmental regulation. Across the different regulatory regimes, policy changes are on the way and some, such as the Paris Agreement, are already in progress. This UN framework seeks to tackle climate change, and countries like China have committed to reduce carbon emissions significantly from 2020. Norway and The Netherlands agreed to ban diesel and petrol-fuelled cars to reach agreed targets, as has France, which also committed to no longer using coal to produce electricity after 2022.

Climate change now demands strategic scenario planning and investment. As most of Europe was gripped by an extended heatwave during 2018, attention turned to how utility providers could maintain continuity. Will we need more reservoirs in the future? Should we have contingencies for a freak solar flare that takes out half the world's power transformers in an instant? The US felt this back in 2012 in the wake of Superstorm Sandy, which saw utilities invest in strengthening the resilience of the grid and deploying smart technologies to avoid future outages³. Globally, climate change throws up new events and localized extremes, while the world is watching to

figure out what the utility company of the future needs to do. When the 2011 Fukushima disaster occurred, where an accident that couldn't possibly happen did happen, countries around the world considered the implications. Germany, for example, reviewed energy strategy at a national level and set an aim to eliminate demand for nuclear by 2022. Other countries continue to see nuclear as the solution to fight climate change now that there is a general preparedness to accept this is a real problem.

The increasing demand for renewable and alternative sources of energy is now part of consumer thinking, and even action to positively select renewable source providers over others, thereby driving incredible growth in the companies leading the field of renewable energy or technology offerings⁴. Nor is it just renewables in which consumers are taking an interest. Utilities are now finding themselves accountable to the socially conscious with an increasing body of customers, and millennials in particular, seeking assurance about the integrity of the whole supply chain. This extends to public scrutiny about the level of profit being made by private organizations offering services 'as if they are in the public sector'. Remuneration packages for senior executives are public-interest news stories and there is little place or tolerance for the so called 'Fat Cat' CEOs. Accountability is a prerequisite, as BT discovered in 2017 when there were calls for the leader of its Italian arm to step down following a backlash from shareholders over the company's poor performance⁵.

As if this all wasn't enough, utilities are part of the war that is raging over who will 'own the home' in the future. Utilities are fighting with some of the biggest names on the planet to be the one. Smart speakers and home automation technology and apps might be the 'new kids on the block' claiming territory, but utility companies are caught up in this battle, leading the charge with smart meters. Clearly, the technology drives more efficient billing for utilities and can offer the consumer the apparent benefit of taking control of their usage – these being the key reasons used to mandate roll-out of smart metering. However, both of these benefits pale into insignificance against the value of the data which the utilities can harvest about our usage. Our utility providers now possess the ability to model what is happening in our home; when we are away, when our teenage son has returned from university for the summer, or when one of the heating systems in our house has suddenly failed. Might we want the services of one of their maintenance engineers right now?

Technology is not only affecting the offering utilities can make. The rapid advancement we are experiencing is also increasing the threat of cybercrime. As a provider responsible for public services, and holding huge amounts of data, utilities are close to the top of the target list. They are already investing heavily in cybersecurity and, with the advancement of connected technologies becoming central to their profitability, this trend is only set to increase.

How technology will shake out is hard to predict, but we can be certain that utilities have to do more than simply deliver what they are there to provide. They have to

innovate alongside Amazon, Google, Microsoft and other giants, whilst being handicapped because they are not single global entities but a fragmented group of players all fighting the same fight in their respective territories. In addition, they face unprecedented changes in demand as energy efficiency programs and advancements such as driverless cars shape the future. As PwC stated in its 2017 report⁶, "Because of the changes in customer demand, being a leading innovator is a much more compelling strategy than it used to be in the power and utilities sector..... companies pursuing energy efficiency have two long-standing goals - gaining a competitive advantage and boosting the bottom line - and one relatively new one: environmental sustainability".

WE DON'T HELP OURSELVES

As well as a complex external environment, the utility sector is, in general terms, still grappling with a range of internal challenges. In Europe, larger utility firms still face many of the challenges inherited from privatization alongside a whole host of new ones arising from mergers, acquisitions, and reorganizations. Fragmented organizations, a siloed operating mentality, and a lack of integration are common challenges impacting not only the culture and how people work together or not, but the systems companies use day-to-day. It is not unusual to find a large, modern utility company, which was once a series of small utilities, using the myriad of systems acquired from each operating company consumed into the whole, often containing poor data so even the most basic analysis becomes difficult and time-consuming. The promise of a new system that will consolidate all of this into a single enterprise resource planning and management system is clearly a 'must have'. However, getting this is a bigger challenge that will take many years and is therefore something most have yet to achieve.

Most established utility companies have some form of public sector pedigree, along with a high number of people who share this pedigree and have worked in the industry for many years. Often the inherited benefits packages are too good to move away from – as can be the 'old ways' of doing things. Anyone or anything new has to fight with the established ways. Add to this the 'hard-to-eradicate' silo operating mentality inherited through the way old organizational structures have been combined, and 'old versus new' can be a big hindrance to change. Any inertia here can easily be met with "I've seen it all before, I'll keep my head down and it will go away". Resistance to change in this sector can be so extreme it can even be organized. Safety in numbers with the long-serving employees can be a powerful force. Initiatives to change can even be deliberately sabotaged.

For procurement in particular, there can be an organizational memory from being a state enterprise, causing unnecessary restrictions to be built into processes and systems. In complex areas, such as infrastructure and distribution, this is prevalent with engineers, still mindful of decisions which led to the Deep Water Horizon oil spill, taking a risk-averse view. They are often tied to suppliers they trust, resulting in engineer-led

'contract' strategies rather than the category strategies being developed by procurement. Conversely, the change in consumer demands is also leading to the speedy development of new service lines where stakeholders can't wait for a category plan and require a more agile and responsive service. For these areas in particular a forward-thinking, creative procurement professional has the opportunity to deliver top- as well as bottom-line results.

In recent times there has been a shift in utility spend profiles. Outsourcing has been a trusted friend, and this heavy reliance on external contractors in a market where demands fluctuate brings a raft of challenges. This shift has often been driven by the organization, not procurement. Outsourcing and offshoring projects are often 'executive-driven and managed' with those leading the initiative seeing it as their responsibility, not procurement's. This pattern is currently set to increase. As demand for innovation rises, companies are more likely than ever to look at partnering with technology startups, securing exclusive rights over new technologies, and looking for acquisitions to grow and/or compete. Again, these exciting new projects could all very easily bypass procurement unless procurement is naturally at the table.

The growing need for a flexible contractor base has increased spend on outsourced temporary labour rather than maintaining internal resources. Similar changes have already been implemented in the public sector, where the CIPD states that 51%⁷ of managers report losing highly skilled workers as a result, and the privatized utility sector is now heading for a similar challenge. Add to this the impact of new legislation in Europe preventing contractors being used as if employees, and the cost of labour and how we manage it is set to rise at a time when utilities have to find ways to lower costs.

WHY CHANGE?

With over two thirds⁸ of revenues in utility companies being spent on non-labour costs, with typically limited strategic intervention within this spend thus far, the opportunity for cost reduction from good procurement is vast. However, the benefits go way beyond cost, and extend to the potential that exists in utility companies better connecting with the supply base, in order to drive more efficient and effective operations, and to secure the innovation to help meet the needs and aspirations of the future customer base.

TRANSFORMING PROCUREMENT IN A UTILITY COMPANY

These benefits are not possible by doing the same things we have been doing. They require a new form of procurement intervention, and one that becomes a strategic enabler of competitive advantage for the firm. However, actually making this happen within the myriad of complexities and challenges we have explored thus far requires a well-structured, resourced, company-wide program. That said, with the right approach it is really not that difficult. The problem we need to fix is not typically a

procurement one. Rather, it is one of changing hearts and minds, and getting the entire supplier-facing organization in some way aligned and understanding their role to support a new, modern, value adding, strategic approach to procurement. At the core of this is helping an entire organization understand what "good" looks like. So, less "You should buy this way," and more "If we work together like this, we can be great!"

Focus on establishing procurement policies and procedures, and little will change. Focus on winning an entire organization over for a new cause, and success begins to come into sight.

Crucially, therefore, this is not something that can reside in a utility's procurement department, but must run like veins through the organization. One of the key challenges that hinders effective procurement in utilities is the fact that, by their very operational nature, there are many more supplier touch points than with typical companies. Whilst procurement for big capital projects can often be contained and controlled, it is the rest of the spend that can be a problem in terms of driving any sort of procurement compliance. The legacy of mergers, acquisitions, organizational change, and fragmented operations usually means that utilities lack any central control over spend, added to which is the local teams' preferences for the suppliers they know who help them get the job done. Wherever there is a network of local operational teams tasked with getting the job done, or keeping things operational, any intervention from central procurement to drive standardization, or channel spend to preferred suppliers, will be met with waves of often organized resistance. Therefore, even if a utility company could establish 100% centrally managed compliance over its spend and be part of every operational activity, this still would be deemed to fail due to resistance. The only option for change in a traditional utility company is to win people over to a new procurement cause.

Successful transformation of procurement in utilities therefore requires a number of success-critical steps, or things to be put in place as follows:

I – IT STARTS AT THE TOP

We are driving organizational change here and this starts with clear, unambiguous and highly visible executive support from the top. The entire organization must hear its leaders talk about the imperative to improve how we buy, and what they expect of everyone that plays a part in this. Executive support is not about a single figurehead but a visible alignment within, and the support of, the executive team so the 'new procurement mantra' can permeate the organization. Executive support doesn't just happen, it needs to be won over and kick-started. It is often the case that senior teams don't really understand what, and how important, strategic procurement is. The very first step in any transformation program, therefore, is to find the right friends at the top and work to convince them of the incredible benefits. This might require a degree of education to help see the size of the potential, and procurement's role as a key enabler for the goals they

are already chasing. Transformation cannot happen until the executive team believe the journey is worthwhile and then, and only then, have we reached the point where we can secure the investment and resources needed to make a program happen.

2 – A NEW PROCUREMENT STRATEGY AND ORGANIZATION

Transformation always needs a clear outcome to achieve, together with a strategy to get there. Here, we must define the nature and degree of procurement intervention to be deployed by the organization as part of our strategy, and be aware that it may be different depending on the segment of the industry being served by our businesses. In a large utility, this could mean the development of a differentiated operating and service model, to enable agile services in business units facing fast-changing consumer needs, versus a long-term and well-thought-out strategic approach regarding energy generation, and a more traditional category management approach, still working well for Indirects. The agreed change should also be reflected in organizational policy. This means it is imperative to involve other functions and business units to ensure policies are aligned so that the resultant procurement organization is set up for success - not turf wars.

3 – THE RIGHT STRUCTURE

It might seem that driving-in a new, centralized procurement function could solve all the issues and challenges, and instantly drive compliance. In fact, this would be catastrophic in most utility organizations, even if it were remotely possible. Why? Simply because success in procurement in any utility has to be built on a full and deep understanding of internal stakeholders and what they need to do effectively and efficiently, now and in the future, and then to find a way to deploy a common solution across the business that meets everyone's core needs. Full central control is very unlikely to achieve this.

Similarly, fully decentralized procurement will prevent any strategic procurement intervention. Therefore, the right structure is one that embraces and supports existing decentralized operations, but introduces a new central coordination of procurement activity, operating strategically, and one that seeks to establish new organization-wide procurement approaches. It will also make best use of available resources, and procurement leaders should consult organizational design experts to ensure any new structure motivates people and doesn't hinder their ability to perform.

4 – EQUIP THE CENTRAL TEAM WITH THE STRATEGIC TOOLS AND CAPABILITY

Good strategic procurement needs strategic tools and the capability to apply them. With the primary categories of spend, segmented based upon the organization of the marketplaces from which we are sourcing, category

management is the approach to identify and implement new sourcing strategies for this spend. With identification of the most important suppliers, and what makes them important to us, supplier relationship management approaches enable us to drive in interventions unique to each key supplier, unlocking the value we need. In leading organizations, this is enabled through creative, entrepreneurial, and smart procurement people supported by the right technology. Any digital transformation should be developed during the design phase of your overall transformation plan, not in parallel with the plan or as an afterthought.

5 – CREATE A COMMON PURPOSE AND A FELT NEED

Procurement transformation is about changing hearts and minds. This will not happen unless the people in the organization come to believe in the need to change in the first place. If the view of procurement is as the function that simply buys things, or one that hinders the work of the rest of the organization, there will be little belief and support in the need to do something differently. Successful transformation depends upon creating a 'felt need' across the organization so people come to appreciate the imperative to change, and the target we are trying to achieve by doing what we do. Once a 'felt need' is established, the groundwork is laid for changing how people work. Then the ongoing challenge is to ensure that the internal service experience delivers what is promised.

6 – A NEW ORGANIZATION-WIDE PHILOSOPHY

Procurement doesn't own the suppliers; instead they are the organization's suppliers. This is an important shift in mindset, as transformation requires us to adopt an organization-wide approach to procurement and how we buy. Good procurement is not a function, but a philosophy - and one that is part of what everyone knows and does. In fact, at the risk of being controversial, procurement is ultimately a business process and need not be delivered by a function at all. What is important, however, is that responsibilities are clear and that all parties responsible are aligned and work cohesively.

7 – MAKE SURE EVERYONE IS PART OF IT

Participation is key to driving any change and, in procurement terms, we need the entire organization to participate in the development and implementation of new sourcing strategies. In practical terms, this means establishing cross-functional teams and working with individuals from key functions as part of category management, and supplier relationship management projects, who can represent the needs and interests of their respective parts of the business, as well as acting as an agent for communication and change back in their functions. Cross-functional working is key to breaking out of the traditional siloed operating model found in utilities. It doesn't typically require any organizational restructure, but rather a redefinition of roles and focus, using the

executive support to drive this and, ideally, with success linked to personal objectives and reward.

8 – TRAIN AND EDUCATE THE ENTIRE ORGANIZATION

People outside of procurement rarely learn about procurement when they study their profession. Furthermore, few organizations take the time to educate the wider business regarding what is expected of them. This is incredible when you consider that the majority of supplier interfaces and touch points exist outside of the procurement function. Within a utility company, this is even more pronounced when there is a dispersed workforce with many operating bases, each perhaps an interface, or having dealings, with suppliers. This provides suppliers with a prime opportunity to divide and conquer and achieve local advantage and favour. Key to procurement transformation is providing the entire organization with some basic procurement training and setting the expectations. Helping people to understand how suppliers gain advantage, and providing a simple set of principles or ‘dos and don’ts’, can be a game-changer. This is, in fact, not that hard to do, and can be established very simply through a program of communication, or having everyone take a short eLearning module or watch a short video.

9 – MEASURE SUCCESS

Transformation is not a one-time process but something you start which then keeps rolling down the tracks. If it slows up, new ways will soon be lost, so momentum is key. Maintaining momentum comes by demonstrating the value being delivered by the new procurement approach, which in turn reinforces why it is worth the effort. A system to measure and track benefits is key here, and crucially this must be one that the organization buys into. The successful companies agree this upfront and at the top. A transformation is an ideal opportunity to introduce measures based on innovation, increased revenues, and both cost and risk avoidance, as well as traditional cost savings. Having said that, there is little point in procurement boasting big savings if the Chief Financial Officer either cannot see the benefits appearing on the bottom line, or disputes the claim. So, making sure you have tangible measures is key. Furthermore, an engaging way to report and share the stories of the value secured from non-financial benefits, such as innovation, is highly important. This not only rewards the team for a job well done, but it is the best way to get those harder-to-convince stakeholders on board and drive the behavioural change required.

10 – COMMUNICATE LIKE A PRO

Finally, procurement transformation success requires its own well-resourced, tightly-managed communications strategy and plan. If we are to change an entire organization it is essential to keep the program, its aims, and its successes, front of people’s minds. Companies that do this well create their own ‘mini brand’ for the program, and appoint professional marketeers or communicators to handle this part of the project in the same way a marketing team might approach the launch and promotion of a new product or service.

The ever-increasing complexity for utilities is clear, and many are still grappling with how procurement fits into supporting this. As we have seen, there are many things to consider; however, there is no doubting the size of the prize if we can transform procurement. This is not something to consider over the medium term, but is now a key imperative if a utility provider is to maintain or grow its competitive position - and arguably something that must happen in less than the 2.4 years⁹ usually taken for a transformation of this size. The challenge is how to do it whilst still reducing the cost base.

ABOUT THE AUTHORS



Jonathan O’Brien is the CEO of Positive Purchasing Ltd and an award-winning author of four seminal books in the procurement space. He has over 28 years’ experience working in procurement and significant experience working in procurement within utilities.



Christine Lithgow Smith is the founder of Chrisalyst Ltd and passionate about helping leaders drive positive change. She has 20 years’ cross-sector commercial experience and an extensive track record of leading global transformation programs, including procurement within utilities.

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+44 (0) 33 00 94 0000 team@positivepurchasing.com

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