

MICHAELMAS COURT LUNCH: 26 SEPTEMBER 2012

GUEST SPEAKER

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Master, Wardens, My Lord, Liverymen, Ladies & Gentlemen, I would like to thank The Master for the wonderful lunch and the invitation to speak today. It's a real privilege.

'Balancing Stable Tradition With Innovative Change- The Suppliers Perspective'

A huge topic to cover in just a few minutes!

So, what I'd like to do is take a brief look at:

- What do we understand by innovation & what does it *really* mean in our industry
- Does the water industry *need* to change through innovation?
- & also share some thoughts as a supplier of where innovation is working but also the barriers we encounter.

So,- What is innovation?

Everyone talks about the increasing need to innovate. But what do we really mean?

There are plenty of text book definitions

Innovation has been defined as **'the multi-stage process whereby organizations transform ideas into new/improved products, service or processes, in order to advance, compete and differentiate themselves successfully in their marketplace.'**

Certain industries have always innovated more readily than others. The IT sector is one that springs to mind.

I recently came across a quote from an article which appeared in a journal called **Popular Mechanics written in 1949** and titled 'The Relentless March of Science' :

"Computers in the future may weigh no more than 1.5 tons."

Around the same time *Thomas Watson, Chairman of IBM, was quoted as saying*

"I think there is a world market for maybe five computers."

So, visionaries as well as innovators!

In our industry Innovation takes many forms, e.g.:

- **Business Innovation**-Supply Chain engagement, Joint business plans, Sharing best practise, improved H&S, AND ALSO SHARED RISK
- **Contract Innovation** -Longer frameworks, target costs with pain&gain, KPIs, batching/bundling of projects, faster deliveries through better forecasting /visibility

- **Technology Innovation** Packaged inlet works & std designs, use of renewable energy sources, development of IT - all leading to sustainability & operational excellence

But, Does the water industry need to innovate?

From the outside there is often a perception of a lack of innovation in the water industry.

Partly due to the fact that it is a mature, stable industry utilising (by and large) well proven technologies & processes. And in general delivering a service which is recognised internationally as 'world class'. An industry measured on regulatory compliance and the value it offer its customers.

The Water Company's remit is quite clear (set in part by its Regulators) and characterised by:

- To deliver the very best water quality
- Reduce leakage
- To provide value to its customers
- Achieve all its regulatory & environmental obligations
- **PLUS (of course) maximising shareholders return!**

So why change? Well, our world is changing and presenting us with new challenges:

- Climate change
- Population Growth
- Rising cost of Energy
- Need for Carbon Footprint reduction
- A Changing Society
- Need for Sustainability

What does it mean for the supplier?

As suppliers we often complain that **"we need to know what our customers want"**

Customers reply - **"our suppliers would know if they were closer to us"**

Suppliers also complain **"we are good at coming up with new ideas but Water Co aren't prepared to try them"**

Water Companies have been known to say **"we are prepared to try anything new.... Providing it's been proved to work already!!"**

Whilst the last comment is perhaps taken slightly out of context, it demonstrates a serious point THAT THE WATER INDUSTRY IS HISTORICALLY RISK ADVERSE & SLOW to CHANGE.

So, a mature & stable industry, but a conservative one! - How best can suppliers understand what its customers want and how can Water Cos know what suppliers can offer?

Forums such as **British Water's Innovation Days** can be useful first step. They offer potential to:

- **Showcase technologies & solutions**
- **Develop a better understanding of the challenges facing customers and the supply chain**
- **Explore potential scope for savings and efficiencies**

BUT it is essential that drivers and enablers are put in place to ensure that ideas generated can be turned into actions.

Equally important is that barriers to implementation are removed.

As a supplier we encounter numerous barriers- which prevent the industry from adopting innovative change.

One example of this is;

A study carried out in 2010 by the OFFICE OF FAIR TRADING, on behalf of OFWAT, which examined the sewage sludge treatment sector. The study was timed to fit with OFWATs plans to undertake a comprehensive review of how it regulates the industry, with the aim of encouraging water and sewerage companies to achieve better, more sustainable ways of operating.

And there were some interesting findings:

Some Water Companies expressed concerns that cost allocation and transfer pricing rules (*which apply when regulated assets are used to perform non-regulated activities*) are complex, time-consuming and uncertain.

This discouraged them from looking beyond their core business of providing water and sewerage services within their geographic region to contemplate treating sewage sludge on behalf of other companies.

It also found that the Water Companies apparent avoidance of risk (*as opposed to management of risk*) and their associated reliance on guidance also appear to hinder the adoption of innovative solutions for the treatment of sewage sludge. Again, this has resulted in a reluctance to outsource sludge treatment to other Water Cos, even where existing infrastructure and resources show that this would be beneficial.

Suppliers often struggle to get **buy-in** for new products and ideas. One example is the opportunity to recover & utilise the heat in our municipal waste water. The technology exists! - Innovative heat exchangers are available, designed to work with 'dirty' waters, BUT it requires access to the main sewers to recover this heat source. This concept of 'sewer mining' is a relatively simple idea but perhaps not straight forward to implement and one which Water Cos may resist as (*again*) it involves using regulated assets for a non- core activity.

The David Gray review of 2011 found that the cyclical nature of the AMP investment programme has a **major** impact on innovation and efficiency.

The supply chain stated that unless innovation can pay-back within the 3 year period of focused activity, which occurs in the middle of the cycle, then they do not feel able to instigate innovative technologies or business practices. These perceived constraints lead to inefficient delivery and act as a barrier to the implementation of innovative techniques.

In other words- there is a lack of confidence to invest in innovation beyond certain time horizons whereby the returns are unclear.

These concerns are well understood - and Ofwat's Future Price Limits Framework, will address the need for forward planning and communication of a forward pipeline to the supply chain, as well as set out the future process for price reviews. **This is an opportunity to provide confidence to allow innovative ideas to be successfully implemented.**

British Water has estimated the impact of the AMP cycle leads to the loss of between 20,000 - 40,000 jobs across the sector within each five year period, with associated impacts on skills, training, health and safety performance, productivity and morale.

Ofwat has assessed that this lost productivity in the investment programme results in water customers paying an additional £5 on their bills.

Clearly the Regulators remit- "to ensure best value for the consumer" is immensely important. But an agenda where **sustainability** is nearer the top could benefit the industry enormously and help facilitate **innovative change**.

BUT, it's not all bad news! Increasingly Water Companies *are* recognising the need to change and are adopting core values to reflect this.

At a recent Innovation Day, Yorkshire Water shared the Kelda Group's values and behaviours which will help shape its strategic direction over the next 20 years or so:

- We can't do it on our own
- We all make a difference
- We pull together
- We plan ahead
- We think outside the pipes

However, it is essential that the Water Company ensure that its own aspirations and those of its delivery partners are truly aligned.

We need 'joined up thinking' where the high level objectives of the Water Companies are passed down through the supply chain, and best practice is shared not reinvented..

As an Equipment Supplier we're often told by Tier 1 partners:

"WE NEED TO DELIVER THE PROJECT FOR LESS"

So suppliers have to be able to respond to this appetite/need for change and innovation at one level, **but** meet the challenge of delivering **MORE FOR LESS**. And at present must do this, working within the confines of the current AMP cycles. Consequently supplier's investment decisions (including resource levels) are made in this context.

Surely, if the Supply Chain is tasked to provide true long term innovation then this must be recognised and rewarded when it delivers?

Suppliers must not be dis-incentivised, and where for example- they invest money to help water cos become more efficient- these savings should not be lost when efficiency targets are reset at subsequent price reviews.

Some would argue that whilst this can be a difficult business environment in which to operate it has clear advantages over other sectors. Having at least *some* visibility of priorities and investment plans for a 5 year AMP period could be seen as market intelligence not enjoyed by other industries!

So, on the one hand, whilst it is easy to blame AMP cycles & stringent regulation as stifling innovation, as suppliers we need to remember that 'our products & services are sold on the promise of a better future. The purpose of our business is to deliver on promises and profit is the reward for doing so'.

So, in summary, as an industry we *must* preserve the things we do well, which has made our industry a '**world leader**' BUT we must create an environment where we can innovate to outperform, achieve excellence. We must truly understand the meaning of value (not price) & create a win/win for Water Co and the supply chain.

We all have a role to play. Where the Supply Chain demonstrates that commitment to innovate, to invest in the necessary resources and take a long term approach it **MUST** be recognised and rewarded.

The Industry's Regulators can play their part with a more '**sustainability-focused**' agenda, to help change the culture & break down barriers and develop a longer term, less risk adverse, approach.

As an industry we should recognise that we don't always get it right first time- and we should allow for this, & learn from it.

As Woody Allen once said "If you're not failing every now and again, it's a sign you're not doing anything very innovative

So what *might* our stable industry look like in the future with greater innovation?:

- Better integration up, down and across the supply chain
- Recognition and understanding of true value (not just price)
- Sustainable products and processes
- Risks **shared** between Water Co and the Supply Chain
- The Opportunity to grow businesses (both Water Cos and Suppliers')

But we have to be prepared to do things in a different way. After all - if we lived in a world *without* innovative change- perhaps we'd be stuck with computers weighing 1.5T !

A final thought – unfortunately not original (*therefore not innovative on my behalf!*):

Albert Einstein said '**We can't solve problems by using the same kind of thinking we used when we created them.**'

THANK YOU.

Steve Morris, MD Huber Technology. 26 September 2012