GEOFF NUNN & ASSOCIATES

Governance and Board Advisors

Special Issue | Corporate Performance in the Utilities Sector

September 2021

KPIs in the Utilities Sector

Measuring Performance - A Corporate Challenge

As part of our annual benchmark review of the Utilities Sector we take a close look at how organisations across the electricity, gas and water sectors assess corporate performance. Most private and listed utilities align executive remuneration, as delivered through STI and LTI plans, with corporate KPIs. Government owned utilities have been moving away from variable "at risk" remuneration for the last 10 years. Nevertheless they rigorously measure all aspects of their organisational performance and report, on a periodic basis, to their shareholder(s) and various regulators.

Here are some of the changes we've observed during 2020 and 2021:

1. The emphasis on **financial performance** increased in private sector utilities as some boards and executive teams experienced declining return in equity (ROE) and total shareholder return (TSR). The focus on financial measures reduced somewhat in government owned utilities.
2. **Customer service** remains a central platform for all utility companies. Unplanned interruptions have been low despite some catastrophic weather events. Response times have been remarkably good. All focused on operational continuity and community as top priorities.
3. **Health and safety** remains critical for all utility companies given their physical operating base. LTIFR and SIFR are prominent measures along with safety culture. Metrics are fine but the lived experience of safety as an organisational mindset is critical.
4. **Operation performance and project delivery** received increased emphasis over the past 18 months. This is particularly true of energy based utilities as the shift toward renewables takes centre stage. Transformation is well underway despite a lack of clear policy direction from the Federal Government. In 2019 the Queensland State Government took the initiative with the establishment of Cleanco to support its aim of 50% of delivered energy from renewables by 2030.

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Embracing the Renewables Paradigm

In this Newsletter we discuss the challenge of measuring corporate performance in the Utilities Sector. The shift toward renewables is a top priority for all energy-based utilities and water companies are innovating in a range of ways. Environmental reporting and carbon transition are well advanced in New Zealand and Climate Change Response (Zero Carbon) Amendment Act (2019) provided the country with clear targets.

Geoff Nunn & Associates

Geoff Nunn & Associates was established in 1993 as an independent provider of remuneration and governance services to the government and corporate sectors. We specialise in working with Boards and CEOs in the areas of board and executive remuneration strategy, corporate governance, board dynamics and renewal, and governance structures.

Our Services

- Board & Executive Remuneration Strategy
- Innovative Remuneration Solutions
- Board Advisory Services
- Board Governance Advice
- Facilitated Boardroom Dialogue
- Focused Board Renewal
- Board Charter Drafting

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KPIs in the Utilities Sector (Cont.)

Measuring Corporate Performance—The Environmental Imperative

5. **Environmental performance and carbon transition** are strategic priorities for all utilities. Some interesting developments are underway both in Australia and across the Tasman in New Zealand. We'll spend a little time discussing this as it constitutes a fundamental paradigm shift.

In its 2020 annual remuneration report AGL Energy announced that, for the first time, it will include three environmental measures in its executive LTI plan:

I. The emissions intensity of AGL's controlled generation fleet.

II. The controlled proportion of renewable and storage electricity capacity.

III. The total share of revenue derived from green energy.

AGL Energy Annual Remuneration Report 2020 P 84.

The inclusion of these targets supports AGL's Climate Statement to offer customers carbon neutral products.

The New Zealand Experience

In late 2019 the New Zealand Parliament passed Climate Change Response (Zero Carbon) Amendment Act which sets some fairly ambitious carbon reduction targets. The primary target is for net zero emissions by 2050 (excluding biogenic methane). All energy based utilities in New Zealand have taken this on board and are developing comprehensive emission reduction programs. These imperatives were reported by generator and retailer, Genesis:

- Assessment of Climate Change Risk
- Building a Renewable Future
- Transitioning Baseload Generation from Thermal to Renewables
- Managing Seasonal Dry Year Storage Challenges (Water)
- Climate Change Scenario Mapping

Despite a policy vacuum from the Australian Federal Government most utility companies in Australia take very seriously their commitment to ESG principles. Some of the initiatives underway in the water industry across Australia and New Zealand include transitioning to zero emissions vehicle fleets, increased grey water and effluent re-use, future climate modelling, re-vegetation, energy generation from waste and many more. Investment in wind and solar has featured prominently in the portfolios of many superfunds and investment managers.

Fund Managers and Super Funds Flex Their Investment Muscle

On 26 January 2021 the Chairman and CEO of fund manager BlackRock, Larry Fink, wrote to CEOs across the world outlining the Company's investment policy targeting net zero emissions by 2050:

"There is no company whose business model won't be profoundly affected by the transition to a net zero economy – one that emits no more carbon dioxide than it removes from the atmosphere by 2050, the scientifically-established threshold necessary to keep global warming well below 2ºC. As the transition accelerates, companies with a well-articulated long-term strategy, and a clear plan to address the transition to net zero, will distinguish themselves with their stakeholders – with customers, policymakers, employees and shareholders – by inspiring confidence that they can navigate this global transformation."

Climate risk equals investment risk and fund managers are using their very considerable muscle to make the point. Environment, social and governance (ESG) will become the criteria for responsible investment. A little closer to home Aware Super announced in late 2020 that they would be:

- Divesting from thermal coal by October 2021
- Reducing its emissions portfolio by 30%
- Advocating for an economy wide 45% reduction is emissions by 2030

Investment Managers and Super Funds will increasingly target their investment strategies towards environmentally sustainable assets. They will assess social licence to operate, compliance with international conventions, workforce diversity and inclusion, governance practice and board composition. Board and executive remuneration strategies will also factor into decisions as investment managers seek to mitigate against financial, conduct and environmental risk.

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The Governance Environment
Sustaining Performance

Strategic Navigation in a Volatile Environment

It has been refreshing and quite inspiring to see how utility companies have navigated their way through the challenges of the past 18 months. As essential services providers, managing significant assets, the emphasis has been on operational continuity and customer connections. The boards and executive teams of our utility companies have done a remarkable job of ensuring that electricity, gas and water supply have continued with minimal interruption during this challenging period. Here are some observations.

1. **Business Strategy and Planning:** utility companies have been planning for best, medium and worst case scenarios in the current uncertain environment. They have been setting stretch goals and closely monitoring progress. Board reporting has become more streamlined and focused.
2. **Financial Resilience:** operating cashflow, EBIT, ROE/TSR/CAGR metrics have been reviewed . Reduced revenues have challenged some utilities for a range of reasons. Wholesale electricity prices have been down and feed-in tariffs have impacted revenue.
3. **Operational Logistics:** for some companies the need to re-design the supply chain has been challenging as has deploying the right people in the right place at the right time.
4. **Customer Interfaces:** Net Promoter Scores and Customer Satisfaction metrics have been less important in the current environment. Sustainable supply across multiple platforms plus timing and service delivery have been critical.
5. **Stakeholder Engagement:** Community programs, sponsorships and engagement with key stakeholders has been paramount. CEOs and Boards have raised their profiles to re-assure stakeholders that that they have their interests are at the forefront of organisational thinking.
6. **On-line Capability:** ITC capability has never been more important than right now as employees log-on from home and more customers switch to on-line. Most have set meaningful measures of IT effectiveness and security as part of their strategy.
7. **Workforce Deployment:** At various times of the year most utilities have had a significant proportion of their employees working from home. All have increased their focus on mental health and engagement. Employee engagement scores are at best a surface indicator of corporate culture. Whilst these scores feature in many organisational dashboards some are undertaking a deeper analysis as part of their ongoing workforce strategy.

The following navigation model broadly summarises our approach to strategy development in the current environment:

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Each organisation's model needs to be built to suit the specifics of its operating environment. Ownership structure and the regulatory regime have a significant impact on strategy development.

During the past 18 months boards and non-executive directors have been actively engaged in developing strategy. Board meeting frequency has increased with some reporting 18-24 full board meetings during FY 2020 and 2021.

We specialise in the development of balanced scorecard approaches to measurement of corporate performance particularly as a driver of STI and LTI Plans. Our approach has always been to ensure the interests of all stakeholders through setting balanced and transparent corporate KPIs. Please refer to:

https://www.gna.net.au/strategic-navigation-1

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