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The Challenge of Outsourcing

HANDING OVER CORE COMPETENCIES

In today's cost-conscious, "back-to-basics" utility environment, something's got to give.

By Warren Causey

Outsourcing major IT systems business processes has been a sensitive matter for most major investor-owned utilities (IOUs) in the United States for some time. Historically, utility executives have been willing to outsource non-core functions, such as tree-trimming, bill printing, or even meter reading occasionally. However, when it came to customer care, work management, outage management, field services, or other central information technology and business processes, they were — with a few notable exceptions — generally reluctant to let anyone else have access to what they considered core data and competencies. Simply put, it seems the "old-school" utility culture has had a hard time letting things go.

Although smaller utilities have embraced the trend of outsourcing core functions at a greater rate than the big IOUs, which control about 80 percent of the overall U.S. energy market, the change has been too slow to support the number of vendors that jumped into the market in the late 1990s and early 2000s.

After the collapse of deregulation, many utilities have found themselves strapped for operating revenue by a rather precipitous "back-to-basics" movement in delivering energy that was necessitated by what turned out to be a short-lived boom — and faster collapse — in high-growth-rate non-regulated subsidiaries. Eugene (Gene) Zimon, senior vice president and chief information officer (CIO) of NSTAR, Massachusetts' largest IOU with about 1.4 million customers, sums up the problem this way:

"As a company, we have decided to focus on the distribution and transmission business, and that has limited organic revenue growth within our footprint," Zimon says. "Yet, at the same time, we are facing what I would call 'uncontrollable costs,' including pensions, health insurance, and wages, which put upward pressure on operating costs. Therefore, if you have relatively flat revenue and

rising costs, something is going to have to give if you want to continue to grow earnings per share."

"That means the company must take ongoing cost-reduction measures. The only way we can do that is through focused improvements in the way we do business," Zimon says. "It isn't cut-and-burn — we have to really look at our processes and simplify and optimize them."

In addition to process optimization, Zimon sees more externalization in his utility's future, which translates into anything from business process outsourcing to external processing through a partner. "I see the latter as being more important, which has implications, because now you're really extending your processes outside your enterprise," he says. "You also have to develop a level of integration and security to support that."

According to Zimon, the advantage of outsourcing is you only pay for what you use. NStar already has an on-demand outsourcing model for its mainframe computing with IBM, is in the final stages of outsourcing a new interactive voice recognition (IVR) call system for outage management, and is looking at the possibility of outsourcing a work management system. Although Zimon is not ready to announce what vendor will be supplying the IVR service, he did say that the two parties are in final negotiations on the system, which will operate on an application service provider (ASP) basis.

While NStar has followed the outsourcing path quietly and at a relatively modest pace, other large utilities have taken different approaches. A few, like Xcel Energy in Minneapolis, and TXU in Dallas, jumped in with both feet. New Orleans-based Entergy, on the other hand, has taken a more conservative route — but at a more aggressive pace than NStar. Despite their different approaches, all of the companies described below are prime examples of putting the "do-more-with-less" mindset into practice.

Alliance Data Systems Supports Atlanta Gas Light CIS Application Management

THE OPPORTUNITY

The advanced state of deregulation in the natural gas industry in Georgia has caused increased competition for AGL. As a result of this increased competition, AGL has pursued a relentless drive towards operational excellence and has developed a desire to have a more predictable cost base. To achieve these goals, AGL decided to outsource the daily maintenance and support of its Customer Information System (CIS).

Atlanta Gas Light (AGL) is a subsidiary of AGL Resources, the second-largest natural gas-only distributor in the United States, serving over 1.5 million customers in Georgia and Tennessee. AGL needed a company to manage its CIS who could bring value to its business by delivering quality, reliable service at an affordable cost. Because it sought a long-term agreement, AGL required a partner with the following characteristics:

- A comprehensive understanding of the utility industry, especially natural gas;
- An in-depth understanding of deregulation and the effects thereof;
- The ability to translate AGL's business needs into system requirements;
- The ability to make timely, quality enhancements to the CIS system;
- The ability to cost-effectively manage, support and upgrade the CIS system.

THE APPROACH

After evaluating their alternatives, AGL turned to Alliance Data Systems. Due to the quality of the consulting base at Alliance Data and the depth of experience Alliance Data's consultants have in the energy industry, AGL recognized that Alliance Data had an unusually strong understanding of the effects deregulation will continue to have on AGL's business. AGL felt that Alliance Data had the best skill set to deliver its requirements and signed a multi-year Application Management Agreement with Alliance Data.

After assuming management of AGL's CIS, Alliance Data implemented its proven methodology for quality assured system maintenance and support. Alliance Data reviewed all outstanding requests for system enhancements and opened dialogue with business users in different areas of AGL to fully understand their objectives.

Requirements were then prioritized according to criticality to the business and a plan for delivering the requirements was developed. Alliance Data continues to deliver against this plan. Moreover, Alliance Data created scheduled forums for discussing new ideas and requirements on an ongoing basis to keep the business fully engaged in the continued management of the system. To ensure that Alliance Data delivers the best quality service possible, Alliance Data defined a set of Service Level Agreements with AGL that define the level of customer satisfaction, system availability and success rate measures that AGL should expect. These

Service Level Agreements ensure that Alliance Data continues to deliver the value and operational efficiency that AGL was searching for when sourcing a partner to manage its Customer Information System.

THE RESULT

After Alliance Data assumed management of AGL's Customer Information System, operational efficiency improved for AGL substantially. Alliance Data delivered improved responsiveness to the business users by prioritizing the demands made on the system and delivering all requirements according to a quality assured methodology. Alliance Data has initiated direct measures focused on elevating communication with the business users and has substantially improved the time to market that AGL can expect on difficult requests and enhancements to the system.

AGL is now able to deliver better customer care as a result of higher predictability and reliability in its CIS and the associated costs. The quality of the upgrades delivered by Alliance Data has ensured a more efficient and competitive operation at AGL.

The relationship between Alliance Data and AGL has truly achieved a partnership status. It is common for representatives from Alliance Data to represent AGL to the Public Service Commission and to Natural Gas Retailers on matters associated with deregulation's impact on customer care and billing.

“I sleep easier knowing they are taking care of our mission critical CIS system.”

“Our outsourcing agreement is not simply about generating cost efficiencies; it's about supporting the transformation of our operations to achieve enhanced levels of service delivery in the long term. Alliance Data brings to the table deep expertise and diverse experiences in customer management services.”

“Alliance Data provides me the breadth of industry and technical know-how typically found only in much larger firms, complete with the attention to detail and customer focus you'd expect from a niche provider. I sleep easier knowing they are taking care of our mission critical CIS system.”

– KRISTIN KIRKCONNELL, CIO, AGLR

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Xcel Energy Outsources

Outsourcing information technology (IT) at Xcel dates back prior to the two mergers that actually created the company.

In 1994, Xcel's Chairman and CEO Wayne Brunetti was brought in from Florida to become president and chief operating officer of Public Service Co. of Colorado (PSCO), Denver. Eighteen months later, he became CEO. Brunetti brought with him the concept of integrating IT as part of the company's strategic plan. As early as 1994, he decided Xcel was in the power production and delivery business — not the IT business. As a result, he hired IBM to take over IT operations and entered one of the first business process outsourcing (BPO) arrangements in the utility industry.

Two years after the IBM contract was in place, PSCO merged with Southwestern Public Service Co. in 1997 to create New Century Energies (NCE). Once again, Brunetti and New Centuries found themselves dealing with IT at a tactical level — each of the merged utilities had a different set of systems that needed to work together. After two years of trying to transition IT from a tactical to strategic operation, Brunetti was still not satisfied with the results.

The initial contract with IBM was a fairly standard outsourcing arrangement under which IBM operated PSCO's and then New Century's systems at negotiated rates and service level agreements. The contract was designed to save New Century Energies money by reducing the overall cost of IT, but it did little to promote Brunetti's strategic goals. Given his frustration, Brunetti began renegotiating the contract and hired Ray Gogel, then with IBM, to be his new CIO. The new contract included a lot of new ideas designed to position IBM as a strategic partner with the utility, including the following stipulations:

- ❖ The term “second-generation outsourcing” was coined jointly between Xcel and IBM, and the strategic positioning of IT at Xcel Energy became central to the concept.
- ❖ The new contract negotiated between IBM and Xcel enabled IBM to not only to operate and improve Xcel's IT infrastructure, but also to:
 - Guarantee synergy savings, which are reported monthly, from the New Century Energies-Northern States Power merger in IT operations for the new company.
 - A performance guarantee tied to Xcel's annual earnings per share (EPS). Rewards to IBM and its executives associated with Xcel's account are tied to certain benchmarks based upon Xcel's EPS.
 - A gain-sharing clause specifying that regardless of which company proposes a new IT initiative, IBM's return is based in part on how much money the initiative saves for Xcel.

Slightly more than 10 years after the original outsourcing contract, Xcel has embraced what it calls “The Utility of the Future” philosophy, which envisions a utility that is entirely symbiotic with a number of vendors and provides customers with a seamless relationship with the utility. Through its relationships with NStar, Xcel and other utilities (as well as companies outside the utility's vertical), IBM has gradually evolved its utility outsourcing capabilities and housed them in a division it now calls IBM Global Services.

Xcel and its predecessors had a slightly different driver than companies are facing today. Nevertheless, the need to return to its core business was a significant part of the outsourcing odyssey. When asked about the arrangement, Brunetti frequently tells people, “Look, I'm not going to get linemen to climb poles any faster or meter installers to put in meters any faster. The future of productivity improvements has to do with the systems we use to plan, buy, and schedule things for our crews and our company.”



The TXU Story

In a deal put together in just a little more than a month's time, TXU made a surprise announcement on May 18, 2004: The company was transferring its entire IT division (about 2,700 employees) to a new joint outsourcing venture with Capgemini, a worldwide consulting firm with headquarters in Paris. TXU had run into customer complaints and some regulatory scrutiny in Texas as a result of an aging IT infrastructure and some other missteps in Texas' retail market. The utility also had replaced virtually its entire executive leadership only three months earlier.

In the deal, Capgemini Energy Partners was formed to take over TXU's IT operations on an outsourced basis. It hopes to leverage those operations into an organization capable of expanding to other utilities. "Our intent is to leverage the assets of TXU — both people and systems," said Mark Fronmuller, vice president and practice leaders for utilities in the U.S. shortly after the deal was made. "There are investments from a technology standpoint and a people standpoint. We're ready to go with new clients [other utilities]. We'll look at it on a case-by-case basis, but we're ready to go."

First, Capgemini looked at TXU's in-house capabilities, which included two CISs, one a legacy mainframe system used for customer care and mass residential billing, and a Cordaptix (SPL International product) for the retail side of the business, Fronmuller says. "Cordaptix is one of the reason we believe can bring on more customers," he added.

Fronmuller also explained that TXU possesses some mobile field service assets that might also be leveraged in the new company. "We have another customer that has an interest in mobility and Capgemini Energy Partners will have a lot of delivery capability in that arena," he said.

Apparently, the TXU deal is a fairly straight forward "first-generation" outsourcing contract designed to cut TXU's costs and give Capgemini serious entrée to the U.S. large-utility

outsourcing market. Whether Capgemini can succeed in expanding its operation beyond TXU remains to be seen. But TXU built a number of service level agreements into the contract designed to improve what had become a difficult IT environment.

"Capgemini will develop and implement new business processes and rationalize existing services in order to enhance operational efficiencies and leverage new technologies," said new TXU CEO John Wilder, when the deal was announced.

TXU also held a hedge against the possibility that the new venture might take off, retaining about a 3 percent stake in Capgemini Energy Partners. The total deal was for \$3.5 billion over 10 years, making it one of — if not the largest — outsourcing contracts ever signed in the utility industry.

Given the difficult circumstances in which TXU found its IT operations and the massive leadership change three months earlier, the main impetus for this deal was to solve immediate problems. But the basic driver remained the same: An inability to put the necessary resources into IT to realize the operational efficiencies necessary in the current cost-constrained structure under which utilities are required to operate.

The Entergy Experience

Entergy, located in New Orleans, turned to IT outsourcing just before the major crashes hit the industry. The company already had some difficulty with its non-regulated businesses, and decided ahead of many other large utilities to refocus on its core business.

In August 1999, Entergy retained a core "strategic IT governance staff" of about 60 and entered into a five-year agreement to outsource its IT services to Science Applications International Corp. (SAIC) in San Diego. Entergy transferred a total of about 800 employees to SAIC, which assumed responsibility for Entergy's data center operations, distributed servers, desktop support, telecommunications and field services, and applications (development, support, and maintenance).

That original group of 800 has declined to about 530 in recent years — as Entergy has undertaken various "cost rationalization" efforts. Although the Entergy/SAIC relationship is not quite as "strategic" as the Xcel/IBM symbiosis, it has worked well so far. SAIC has been flexible and supportive through what is now a five-year relationship, adding that Entergy is currently involved in studies to determine what other business processes might be outsourced.

Although business process outsourcing still has not taken off among large utilities as pundits have been predicting since the late 1990s, this trend finally seems to be on the cusp of becoming more widespread. The "back-to-basics" strategy has resulted in tremendous financial pressure on the bottom line. And as NSTAR's Zimon says, "something has to give."



CIS Outsourcing Catches On

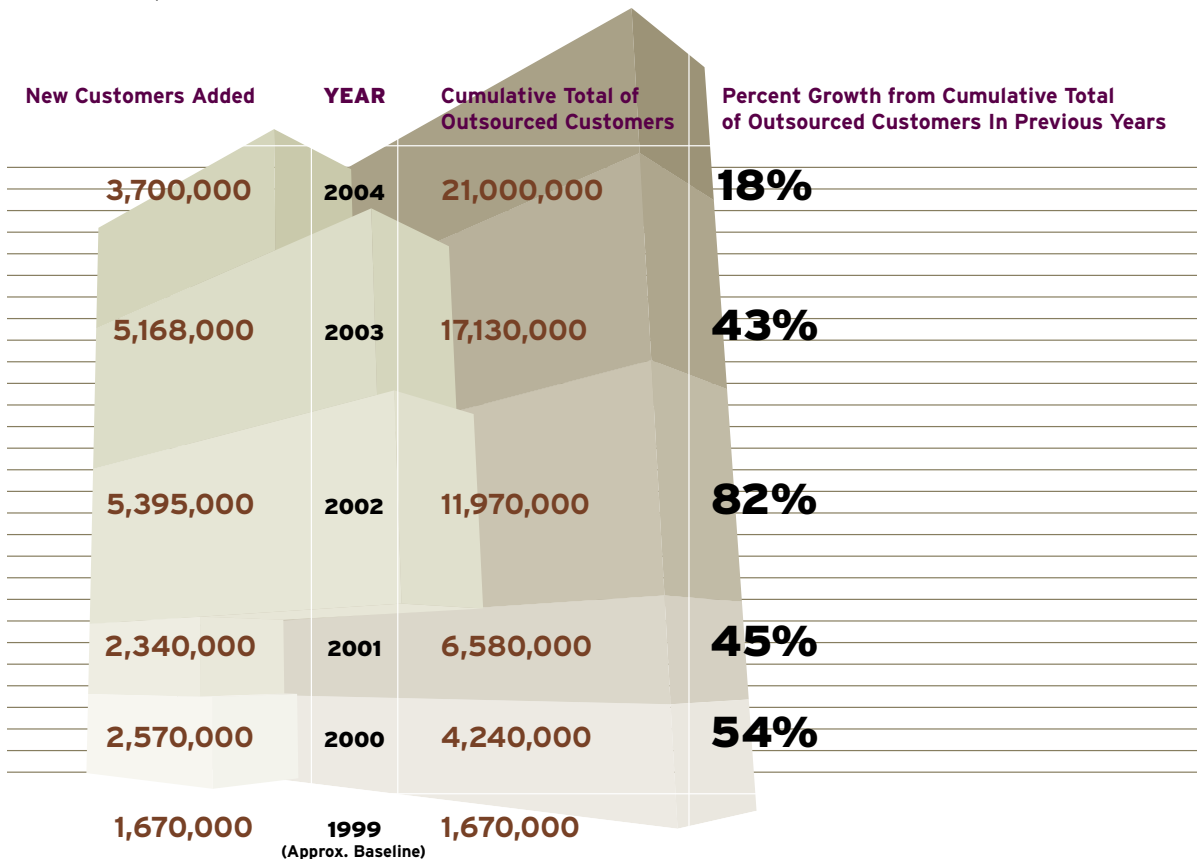
By Warren Causey

While *business process outsourcing* has been gradually expanding in utilities over the years, an alternate form of customer care outsourcing, the application service provider (ASP) model, has caught on since the turn of the century. In most cases, ASP vendors operate customer information systems (CISs) and/or call centers for utilities, although some other services are beginning to come on-line, including such functions as work management.

Prior to Jan. 1, 2000, there were approximately 1.67 million monthly customer bills being rendered by utility companies or energy service providers (ESPs) on an outsourced basis, says recent research from Energy Central/Warren B. Causey Ltd. (WBC). Approximately half of those customers being served also received customer service care through call centers that were outsourced by the utility or ESP.

By the end of 2004, that same statistic stood at approximately 21 million. An unknown, but probably higher, percentage of utility customers also now receive their customer care through outsourced call centers.

The numbers described above represent an average growth rate of approximately 54 percent per year, or approximately 1,151 percent over the five-year period. Expressed another way, there now are 12.6 times as many outsourced customers as there were at the end of 1999, as shown in the chart below.



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Without a doubt, the most dramatic trend in ASP customer care over the last three or four years has been the consolidation of vendors.

Despite what appears to be a healthy growth rate, note that the largest single year for new customers added was in 2002. Since that time, the rate of expansion has slowed slightly, with fewer customers added in 2004 than in any year since 2001.

From our research, it also appears likely that one, or possibly two, ASP-based CISs may be taken back in-house this year. However, it also is likely that one or two other utilities will outsource CIS on an ASP basis this year — which means 2005 is shaping up to be relatively flat.

Without a doubt, the most dramatic trend in ASP customer care over the last three or four years has been the consolidation of vendors. Two major players, Alliance Data Systems (ADS), Dallas, and Accenture Business Services, headquartered in Canada, gradually acquired and absorbed most of the other major ASP vendors in the customer care arena. ADS acquired the oldest and previously largest of these in December 2003 when it purchased Orcom, located in Bend, Ore. Accenture grew its customer care ASP outsourcing by acquisition of CustomerWorks, Markham, Ontario, in July of the same year.

Since those consolidations, the ASP customer care outsourcing market has been relatively quiet. Most of the utilities being served by ASP-based CISs or call centers are relatively small- to mid-sized — most of those having difficulty with billing seemed to already have been served by the ASP vendors.

Despite the large consolidation, there still are a number of smaller ASP vendors still serving additional smaller utility clients. These include Cayenta, Vancouver, B.C. which sells a licensed CIS as well as offers it on an outsourced basis, and Utility Business Services (UBS), Union, N.J. One of the oldest outsourcers in the country, UBS was established in 1969 and is a wholly owned subsidiary of NUI Corp. (NYSE:NUI), an energy, telecommunications, consulting and sales outsourcing company based in Bedminster, N.J. NUI Corp. is a major East Coast gas company that has a significant number of natural gas and water utilities as clients.

One of the reasons there is a relatively small pool of potential outsourcing clients is that smaller cooperatives long have been using ASP services through two co-ops of their own. These are National Information Solutions Cooperative (NISC), St. Peters, Mo. and the Southeast Data Cooperative in Atlanta. Together, these two co-ops provide outsourced CIS and other services to hundreds of smaller cooperatives.

Despite a relative slowdown in growth over the last couple of years, outsourcing among smaller utilities, municipals (munis) and co-ops — and even some smaller IOUs — is a relatively well-established practice.

There are approximately 485 electric, natural gas and water utilities in the United States and Canada serving 50,000 customers or more — plus another 20 or so ESPs that have broken the 50,000-customer level. Combined, these companies serve approximately 197 million customers. Thus, at present, approximately 10.5 percent of all utility bills in the United States and Canada are served by outsourced CISs. Of the approximately 485 entities, roughly 21, or 4.3 percent outsource CIS. What do these figures mean? There is still tremendous opportunity for further expansion of CIS/customer care outsourcing over the next several years. Based on recent industry surveys, as many as a dozen major utilities in the United States and Canada have been exploring outsourcing their CIS.

In the latest survey, Energy Central/WBC received feedback from IOUs representing about 25 percent or 28 million of all end-use customers served by IOUs, and munis and coops, which represent about 10.4 percent, or 2.4 million customers.

“ Despite a relative slowdown in growth over the last couple of years, outsourcing among smaller utilities, municipals (munis) and co-ops — and even some smaller IOUs — is a relatively well-established practice. ”

A surprising 36 percent of IOUs reported they already were outsourcing some functions. That 36 percent still represents a rather dramatic change from five years ago when few large-utility CIOs were willing to outsource anything. The percentage was somewhat lower among municipals and co-ops, but still a fourth of respondents reported outsourcing some customer care functions. When you add another 17.3 percent, either actively considering outsourcing or “maybe” planning to outsource, the numbers become even more impressive among IOUs. Another 31.5 percent of munis and coops are considering moving in that direction. ❏



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The Case for Utility Outsourcing

By Robert Pryor

VIEW FROM INSIDE
**THE CAPGEMINI
STORY**

The adaptation of outsourcing in the utility industry is nothing new. Since 1995, the utility industry has seen 20 outsourcing deals of notable size. But given the extent of the industry's need to meet Wall Street's financial targets by achieving operational excellence, hundreds of utility companies still have room to streamline, modernize, and rationalize their back office business processes with the help of third-party companies.

The benefits of outsourcing include the restoration of predictable growth, improved service levels and quality, and increased profitability for investors. Outsourcing can transform customer service, establishing expectations for best-in-class solutions. By freeing utility management to focus exclusively on generating and delivering electricity, the utility company that outsources its back office business functions can actually increase its commitment to electric reliability. And looking to the future, the prospect for more merger and acquisition activity – and maybe a pick-up in the move toward competitive markets – will further drive companies to ferret out redundant systems and processes through outsourcing.

Outsourcing works for most companies, but transforming a business through outsourcing isn't easy. Utility company executives know instinctually and empirically that basic business services are a time-consuming and costly operating expenditure. Managing those services distracts their focus from their core business of energy production and distribution. Upgrading systems to increase productivity is expensive. But executives face a Catch-22 dilemma and are handcuffed in their search for a remedy: they know their efforts to transform their back office operations are constrained by limited resources and budgets that are dedicated to generation and distribution issues. Executives know also that mid-level management – those who have no real incentive to improve processes so that they are no longer needed – has limited experience implementing the wholesale changes needed to drive dramatic or step-fold improvements. And the executives also know they need to transform their business even while the business is up and running. There's no way they can take shut down utility operations while they re-tool their back office.

Despite those compelling business reasons for considering a third-party change agent, outsourcing is not perceived to be an easy solution. Utilities are wary of losing control of some parts of the business, for fear that an outsider won't be as mindful of functions like customer service or finance and accounting as they are. Outsourcing can add political

and regulatory risks, as anti-outsourcing politicians are grandstanding on a "Keep Jobs in America" platform and misleading people about the net-net positives of global sourcing. And worse yet, those challenges to outsourcing can cause executives to default to the cost-plus, regulated-utility paradigm. Deregulation isn't moving – there's little current incentive to veer from that outdated mode of thinking.

The good news is that prevailing attitudes are changing. For instance, an IDC/Capgemini pulse survey of more than 200 financial decision-makers in April 2004 showed that 24 percent had already outsourced some portion of their finance and accounting function. And, 31 percent said they've already outsourced human resources in some capacity. Confidence in outsourcing is increasing among financial decision makers.

And it's likely that utilities' concerns about customer service metrics will lead them to re-evaluate their options, including the outsourcing of that function. Utilities expect their outsourcing suppliers to deliver the best in service without the traditional trade off between cost reductions and market-competitive customer service. Those expectations demand constant investment in sometimes costly – and fast moving – technology improvements. Utility companies don't have the budget or the experience to keep pace with consumer demands for best-in-class services. For instance, cutting-edge IVR technology is capable of resolving most issues on the first call, a key driver of high customer satisfaction. But updating systems and processes to enable first-call resolution may be too costly without the help of an outsourcer who is selling the service at wholesale prices. Utilities can take comfort in developing strict contractual arrangements around customer service, reinforcing the importance of the care function to the outsourcing supplier.

As outsourcing makes further inroads into the utility industry, companies will take a closer look at the differences between operational and transformational outsourcing. Focusing on only one business service function at a time, operational outsourcing can only take a company so far in delivering needed cost and process improvements.

Transformational outsourcing – a more complete, larger scale reorganization of the way that businesses conduct every back office function – is becoming more attractive to utility board members. Outsourcing can reduce costs by as much as 30 percent, but boards are coming to realize that a solid, transformational

“ Working with an outsourcer – today – will develop a collaborative sense of structural creativity that prepares for the future. ”

outsourcing program should not be limited to just cost-cutting. A good outsourcing arrangement with a qualified partner essentially shares business risks, ensuring that, for instance, technology is beneficially refreshed when appropriate. It mitigates companies' constant need to make large investment decisions. Boards and executive management will come to accept outsourcers once they have confidence that their outsourcing provider is in fact a collaborative partner, willing to work together to achieve the cost reduction and service quality objectives of the program through teamwork.

Another utility industry hang-up about outsourcing has been vendors' desire to move work offshore. It's a mistake to move processes offshore based on cost alone, without paying attention to service quality or leveraging in-place technology and resources. Companies need to consider several solutions when they decide to outsource, including dedicated service centers and joint ventures. Otherwise, they will fail to realize the true potential of offshore outsourcing, not to mention the political and public opinion challenges of recent months around this emotional issue. Outsourcing models that blend onshore, nearshore and/or offshore capabilities, tailored and coordinated to meet a company's specific goals in a distributed delivery approach that balances cost reduction today with business transformation tomorrow. One of the key challenges and opportunities in business today, in any industry including utilities, is sourcing the right skills at the right place at the right cost.

And who knows what tomorrow will bring? Despite the current lethargy of deregulation, the long march of business history indicates the utility industry will someday deal with real competition in one form or another. Every other industry has. Engaging an outsourcer to deliver services that have nothing to do with generation or delivery will give the utility company greater flexibility if – and when – it has to grapple more diligently with competitive issues for its commodity. Working with an outsourcer – today – will develop a collaborative sense of structural creativity that prepares for the future. Overcoming unknown future hurdles will be made easier if today's utility executives have the foresight to embrace their core competencies and leave business process service improvements to others.

The act of outsourcing demonstrates more than business vision. With proper governance models in place, utilities can find significantly better economics through an outsourcing venture. An enforceable contract ensures certainty and confidence in the arrangement and acts to improve service levels. Companies should align incentives with their business process outsourcing (BPO) service provider to take advantage of technology improvements and seek to work on an accelerated schedule in order to minimize disruption and quickly capture value from an outsourcing arrangement. In a collaborative business “partnership,” the risks are identified and mitigated as much as possible, and that can be music to the ears of stakeholders of all shapes and sizes.

Robert Pryor is the CEO of Capgemini Energy.

Transformational Outsourcing: A Year In Review

By Paul O'Malley

VIEW FROM INSIDE

**TXU ON THE
LEADING EDGE**

Until last year, TXU was like many other U.S. utility and power companies, staying steadfast in the belief that company employees generally did a better job of providing services than independent companies. However, CEO John Wilder, challenged the company to reexamine that belief — to rapidly (but thoughtfully) engage the market of service providers and consider alternatives in delivery of speed to value. The result of this burst of competitive and creative activity was the formation of a joint venture, Capgemini Energy, in a \$3.5-billion, 10-year deal and the subsequent transfer of 2,700 employees to the new entity in only two months.

By adding transformational outsourcing to its business model, TXU hopes to improve its cost position, optimize service delivery, and catalyze cultural change. Under the agreement, Capgemini Energy will take on TXU's support services (customer contact, revenue processing and collections, information technology, supply chain, human resources and certain finance and accounting functions). Because this new business is uniformly focused on such crucial processes, it fares well in attracting talent and capital.

Before making this move, TXU's previous experience in outsourcing had been limited. The concept of outsourcing functions like customer care had previously been applied to peak assistance, not baseload functions. Nevertheless, the transition was well executed. In fact, during the transition, Dallas was hit with a storm that caused more damage than any in the last 100 years. Our line crews, as well as the transitioning employees in the call centers, performed with distinction in the restoration of service.

Now that we have almost a year of operating experience under our belt within the new construct, I will address some of the questions decision-makers have posed to our leadership team as they examine our model and evaluate their own operations for this type of arrangement. In so doing, I hope to offer a unique perspective. Prior to joining TXU as senior vice president of business operations and CIO, I had the opportunity to work on outsourcing issues at SAIC and other companies — so I've been on both sides of the outsourcing equation.

WHY CHOOSE LARGE-SCALE OUTSOURCING IN THE FIRST PLACE?

TXU chose large-scale outsourcing because it enabled us to rapidly achieve operational excellence in ways otherwise unattainable. After significant research, we concluded that incremental change would simply not accomplish our business goals. We also captured three important benefits from the deal:

1) Cost savings: This 10-year business agreement with Capgemini Energy will save TXU \$175 million in annual operating costs.

2) Operational excellence: Operational excellence metrics are stipulated by contract. We know we will gain increased functionality, innovation and continuous improvement — it's guaranteed.

3) Sustained benefit and continuous improvement: To drive step function change, many companies engage consultants and professional services firms as catalysts for innovation and transition to best practices. Too often, the change and corresponding value diminish significantly over time. Our arrangement with Capgemini Energy guarantees step function change, sustained benefits and incentives for continuous innovation.

DON'T YOU INCREASE YOUR BUSINESS RISK BY OUTSOURCING THINGS LIKE CUSTOMER CARE?

This was an issue we considered at length. Ultimately, we decided that it helped mitigate our risk by transferring financial and technical risk to a specialist firm. Combined with the metrics and financial penalties put in place for failing to meet specified standards, we found the solution we needed. In fact, since last July, we have seen tremendous progress in operational performance. For example, in our contact centers, the outsourcing arrangement was a critical enabler in our efforts to reduce customer call wait time from more than 300 seconds on average to less than 15 seconds.

FOR AN AGREEMENT THAT WAS ACCOMPLISHED IN SUCH A SHORT PERIOD OF TIME, HOW DID YOU INCORPORATE IT INTO TXU'S DAY-TO-DAY BUSINESS?

Large-scale outsourcing is not easy. Like any significant endeavor, business integration required meaningful effort. To the company's credit, we recognized the importance of getting it right from the beginning. To accomplish this, TXU created an organization whose work focused on three things:

1) Commercial management: This team continues to be the centralized source of contract and financial management. They manage contract terms — serving as the primary contact point for contract issues, negotiations, enhancements, and modifications. They are also responsible for monitoring service delivery performance and

on topic

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cost savings, tracking monthly charges and service level credits to ensure accuracy. Outsourcing agreements like ours succeed or fail, in part, because of day-to-day decisions. This team helps manage those decisions to TXU's benefit. Moreover, it enables the broader workforces of TXU and Capgemini Energy to focus on creating value, relieving them from the administrative burden of value measurement and contract compliance.

2) Transition management: For the first six months of the agreement, a small team was responsible for the transition of work to Capgemini Energy while ensuring service continuity, process migration, value realization, change management, and the fulfillment of agreement conditions.

3) Relationship management: Also for the first six months, we dedicated a team to execute, and, as necessary calibrate, the formal governance structure between TXU business units and the new company. This group represented TXU business priorities, assisting with demand management, and monitored service scope and quality on behalf of TXU. Most of these responsibilities now reside in each TXU business unit.

HOW HAVE YOU DEALT WITH THE INEVITABLE BUSINESS CHALLENGES?

Fortunately, both TXU and Capgemini Energy recognize the value of a constructive partnership, so we have a collaborative, day-to-day working style. When there are problems – and with an arrangement of this size there are problems – we deal with them together and immediately. No one wants to see the first hint of a problem on a monthly report.

Still, the reports are important. We use our management dashboard to track and trend hundreds of key performance indicators. To date, Capgemini Energy is meeting or exceeding about 98 percent of these metrics. When trends track unfavorably or other issues are noted, we work together on root cause analysis and execution of remediation plans.

WHAT WAS THE IMPACT ON YOUR EMPLOYEES?

As with any change of this size – the impact was mixed. Intellectually, everyone at TXU knew this initiative was going to involve substantial change, and the reality of that change was difficult. Here are some examples of actions we took to help manage this change:

Regular communication: In dynamic situations, people will make up their own answers if they are not provided with alternatives. Both TXU and Capgemini Energy communicated early and often about the details of changes to minimize or eliminate any impact on day-to-day business. We also established an on-line forum about the agreement and provided a way for employees to ask questions electronically and have the answers posted for everyone's benefit. Hundreds of questions were answered this way, resulting in business continuity.

Transitioned employees: We treated transitioned employees fairly and with respect. Because the transfer of employees took place halfway through 2004, all employees who transferred from TXU to Capgemini Energy also received a portion of the TXU annual performance bonus. In addition, with likely reductions in force by Capgemini Energy, TXU offered a separation package for eligible TXU employees who transferred but were subsequently separated during the first 18 months of the deal.

So do I think we
are at the front end
of a trend? I do.

WHAT ABOUT THE CULTURE CHANGES THAT NEED TO TAKE PLACE WITH SUCH A DEAL?

That's an ongoing process. We went from a model where employees who could walk into an office and ask for a service or a new report without any problem to needing new processes to track requests. You cannot underestimate the work it takes for a company to become a "new" customer of large-scale outsourcing. We are making measured progress; but we still have a ways to go. We have a fundamentally new way of doing business that's characterized by a culture of discipline. Our drive to extraordinary business results will be through innovation and sustained change.

DO YOU THINK LARGE-SCALE OUTSOURCING WILL BECOME AN INDUSTRY TREND?

We are extraordinarily pleased with this strategy and its execution thus far. It seems inevitable that the financial and operational results we have been able to achieve through this vehicle will warrant consideration in the broader marketplace. Of course it's not easy – structural evolution never is. So do I think we are at the front end of a trend? I do. But it's important to note that the circumstances of every company are different. Their decisions will be influenced by a variety of factors — from their competitive position to the capacity of their workforce and infrastructure to sustain significant change. Therefore, adoption will probably be uneven.

IF YOU WERE GIVING ADVICE TO ANOTHER COMPANY ABOUT LARGE-SCALE OUTSOURCING, WHAT WOULD IT BE?

Assemble a strong project team to deal with the details early. In our case, a group of internal subject matter experts for in-scope processes invested significant time in the contract before it was signed. It is the foundation of our agreement, and we're glad we took the time to think through the details. ❖

Paul O'Malley is the chairman and chief executive of TXU Energy and is responsible for retail, business and wholesale markets, comprising all deregulated marketing and trading activities as well as customer service and operations.

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Erich Kreidler, US Technology
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Thomas Lord, Volatility Managers, LLC
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Gerry Crooks, Avista Advantage
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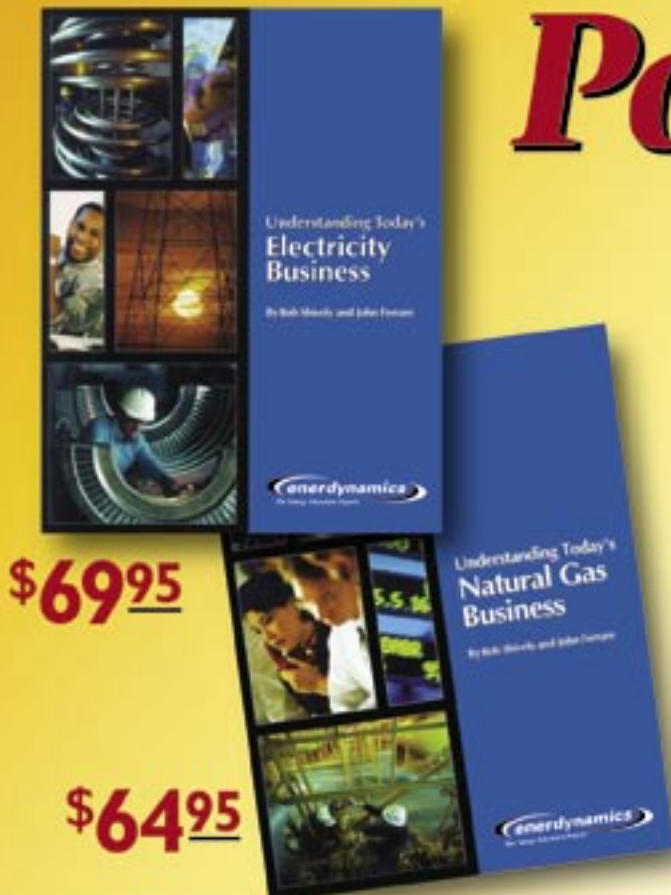
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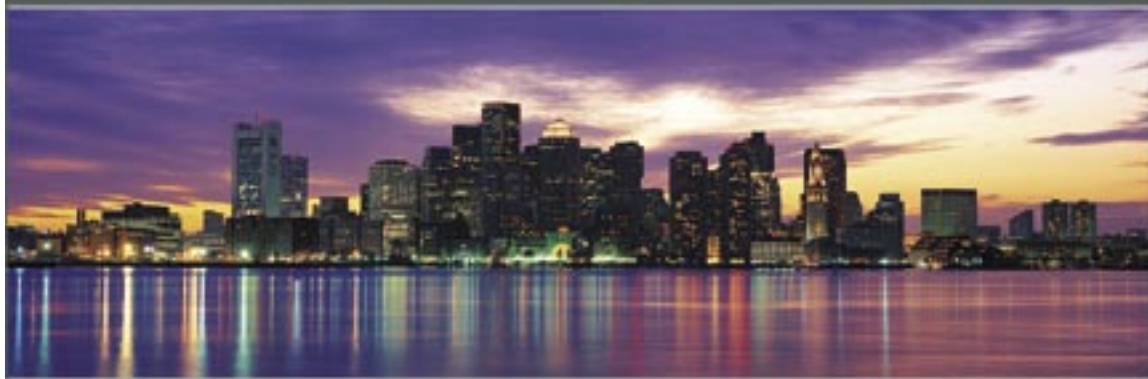


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