

REMARKS BY

SIR ROY GARDNER

CHIEF EXECUTIVE, CENTRICA PLC

At

Energy Institute – Melchett Medal Award

Lecture

Date: Tuesday, 22nd June, 2004

Venue: Royal Aeronautical Society,

London

Sponsor: Norman Broadbent

Good evening ladies and gentlemen.

I'm delighted to be with you this evening to receive the 70th Melchett Medal in recognition of services to the energy industry. Given the distinguished list of past recipients it's truly an honour to be here.

I want to start by thanking the Energy Institute for bestowing this award upon me.

In return, I'd like to recognise the Institute for the very valuable work they perform. They've become a respected and

authoritative voice on all matters energy – which as we all know have a direct impact on business, the economy and, thus, society at large.

[PAUSE]

Tonight, if you'll permit me the indulgence, I'd like to share the Centrica story with you, because in many respects it's the story of my own career in the energy industry. Over the past 7 years we've climbed from the bottom of the FTSE 100 to within the top 30 where we sit today. It's been an exciting journey – a journey of transformation and growth.

I'll also take this opportunity to speak to you about a particular issue that's fundamental to the future success and well-being of the energy industry. It's an issue that we ignore at our own peril, and therefore one that I take very seriously at Centrica – the battle for talent.

[PAUSE]

You probably don't know this, but my boyhood dream was to play professional football. I was – and still am – crazy about the sport. I had a trial for Queens Park Rangers when I was 14, and even spent

the summer after my A levels working double shifts at the local bacon packing factory trying to earn a bonus to buy new football kit. Now that's dedication!

But at one point, I had to take a tough look at my chances and ultimately decided to focus on a career in business instead.

After school, I decided not to go to university, but joined the British Aircraft Corporation instead -- mainly because they had a good football team! However, I soon figured out that the way to get on was to qualify as an accountant. So I

joined an accounting trainee scheme, studying by day release.

Over the next 30 years, I worked my way up the ladder, first at BAE and then within the defense and telecommunications industries. It wasn't until 1994 that I "saw the light" and decided to join the energy industry.

I stepped down as Managing Director of GEC Marconi to be the Finance Director of British Gas. But I did it with the promise of things to come... and upon demerger in 1997, I was given the opportunity to lead Centrica.

It was an exciting time. Competition in our core market was approaching rapidly.

And frankly, we weren't in the right shape to compete.

We had a fairly well-deserved reputation for poor customer service and most people expected our customers to desert in droves.

In addition we were saddled with an uncompetitive cost base. Our take-or-pay contracts represented a £4 billion exposure. And on the people side, we suffered from considerable over-staffing.

Given all these problems, it's little wonder that many of my friends and colleagues thought I was mad to take the job as Chief Executive. One critic even took to calling the company Duff Gas plc ... which really hurt!

Of course, since then we've answered our critics pretty decisively. But to do so, the company had to go through a tremendous evolution – I'd even go so far as to call it a revolution.

Our first priority was to figure out how to retain our domestic gas customers in the

face of competition. We felt like sitting ducks looking at the 25 aggressive new entrants getting ready to take us on.

To survive, we had to study our customers and understand how to serve them better – better than we had in the past, and better than the competition. The key was changing the internal mindset so that people would start thinking of customer service not as a cost, but as a source of competitive advantage.

To do this, I brought in a new management team to infuse the company with new ideas and energy. We also

restructured the bonus scheme so that people were rewarded not only on financial performance, but also on customer satisfaction levels.

In short, we worked to create a whole new culture. The old British Gas, like many companies of the time, was pretty much a “cradle to grave” employer. People joined straight from school and were promoted incrementally ... until they reached a job that was just a little bit beyond their abilities. And there they stayed until they retired.

There was little mobility, either geographically or functionally. An engineer in Newcastle became a more senior engineer in Newcastle. An accountant in London became a more senior accountant in London. A senior manager in head office, became a very senior manager in head office.

Now I'm generalising and there were, of course, many exceptions. But I'd suggest that for the majority of people in the old British Gas, that was what it was like.

Perhaps this didn't present too much of a problem for the former state monopoly.

But privatisation and the opening of our core market to competition meant that the old ways had to change. In order to get the business in shape, we had to improve our productivity and sharpen up our processes.

While we worked to transform our culture, we also acted decisively to improve our cost structure. The successful renegotiation of our debilitating take-or-pay contracts was crucial. If we hadn't tackled this early on, we'd never have been able to survive, let alone grow to the extent we have.

We also clamped down on some of the loss-making activities we inherited. If you can believe it, our Services division (which was responsible for the installation and maintenance of domestic gas central heating systems) actually posted a loss of £400m in 1995.

The problem was that they'd never been required to make a profit. And so over the years had become over-staffed and inefficient, with outdated work practices.

Yet in this loss making business, we actually saw the opportunity to differentiate British Gas from the

competition. With this idea in mind, we set out on a turnaround campaign.

To give you an idea of how radical the ensuing surgery was:

- We reduced the number of employees in the home services division from 23,000 to 8,300;
- We cut the number of depots and district offices from 420 to 6; and
- We succeeded in doubling engineer productivity from 3.5 to 7 jobs per day.

Today, British Gas Services is both profitable and growing. In fact, we can't hire enough service engineers to keep up

with the demand. And as we'd hoped, it has provided the crucial differentiating factor for us in what is now a fiercely competitive market.

In short, we've succeeded in creating a different business model. A model that puts customer service at the heart of our business.

And as a result, we've not only retained over 60% of the UK residential gas market, but we've also become the largest domestic supplier of electricity, with almost a 25% market share.

Abroad, we've begun to export our expertise in energy and energy-related services to North America and Continental Europe.

But as you know, Centrica is more than just a traditional energy company. We also provide road and financial services under the AA brand...and have a growing presence in the fiercely competitive telco market.

[PAUSE]

The extent and pace of change over the past several years has been tremendous.

But it's succeeded in achieving the strategic and cultural change we needed. Specifically, it's allowed us to bridge the transition from the old world of regulated returns and monopoly power to the new world of free market competition.

The Centrica story is in many ways the story of energy market liberalisation in the UK. Having gone through the process, we're now great believers in competitive markets and what they can deliver to consumers – as well as our shareholders.

The opponents of liberalisation often point to security of supply as a reason for

concern. There's been a lot of scaremongering in recent months about the lights going out. But despite all these predictions, the electricity and gas in Britain continues to flow.

Anyone who points to the London blackouts should remember that this incident was due to a faulty component and not a lack of capacity. In other words, capacity payments wouldn't have helped!

In electricity, the introduction of NETA brought much needed transparency to the market. Consumers have benefited from lower prices. And now that wholesale

prices have started to strengthen, market participants are responding by bringing mothballed plant back on-line. They're even looking at investing in new generation, such as we've done with the acquisition of a development site in Devon.

Similar behaviour can be seen in the gas market. With the UKCS in decline, the UK is set to become a net gas importer like the large majority of other G8 countries. To cater for this eventuality, market participants are reacting by investing in LNG, new pipelines and increased capacity in the interconnector.

It's for these reasons that I don't believe the UK energy market is 'bust'. Quite the opposite. Industry players are responding to market signals – demonstrating that a competitive market, which is allowed to function properly, is the best way of ensuring our future supplies.

Looking across the Channel, I hope we'll begin to see equally competitive markets develop in Europe. The Energy Directives are a big step in the right direction. But clearly, there's still a lot of implementation work to be done before we have a single European energy market.

We'll be watching with interest what happens on July 1st when (theoretically) the markets are supposed to open to competition for SME customers.

[PAUSE]

Centrica's come a long way over the past seven years. And whilst it's always nice to reflect back on our journey, what I find even more rewarding is getting to map out our road for the future.

Based on our plans, I'm confident that we'll continue to grow our businesses in

the UK – while at the same time forging ahead in both North America and Europe.

Of course, success will depend on our ability to attract, develop and retain the very best talent. So one of the ways I look after our future is by ensuring that we work to identify and nurture the next generation of employees.

Every year, we carry out a major management talent exercise, which is then reviewed on a quarterly basis. This tells us how much talent we have and where it's located in the organisation.

We can then spot areas where we're strong, as well as areas where we're underweight in certain skills or experience. With this insight, we then focus our training and recruitment efforts to maximise value for the organisation.

For the long-term viability of any company, employee development must be a priority. Giving people the opportunity to develop new skills and experiences also increases their marketability both internally and externally.

I believe that taking high performers out of their comfort zones and throwing them

into new, challenging situations is one of the best ways of assessing their leadership potential.

Moving people between functions and industries broadens their experience and exposes them to new market dynamics and management practices. Talented, high potential employees will emerge as better leaders from this type of exposure.

That's why at Centrica, mobility isn't just possible or encouraged ... it's actually expected for those people who want to test the breadth and depth of their skills and progress within the company.

[PAUSE]

Alongside our leadership talent programmes, we also pursue a robust policy of workplace equality and diversity.

This isn't altruism on our part, or merely something to look good for our annual report. Rather, we believe it makes good commercial sense to have a diverse workforce, as they're better able to understand the needs and interests of our diverse customer base.

Centrica's strategy is built on deepening our relationships with customers. So anything that helps us understand our customers better can only be good for us. Let's call it "enlightened self-interest".

Our policy is to recruit the most talented people out there, irrespective of gender, race, religion, disability or any other social label.

By opening ourselves to a wider pool of potential employees, we're better able to serve our customers, and at the same time accelerating our aspiration to be an attractive employer within the community.

For example, we offer employment opportunities with Jobcentre Plus to target people with disabilities, carers, lone parents and long-term unemployed people.

We also have several initiatives underway to address the potential skill shortages in the future. We've established a number of training centres around the country to support our aim of recruiting and training some 5,000 engineers over the next 5 years – of which about half will be modern apprentices.

Due to our success in this area, we are also looking to extend the use of government-backed schemes to recruit and train customer service advisors.

That's why I was very pleased when the Chancellor asked me to chair the government's task force on Modern Apprenticeships.

I'm committed to working with other companies – as well as with organisations like the Energy Institute – to move the agenda forward on this important issue.

The way I see it, it's a three-way win ... for young people, employers ... and ultimately UK plc.

[PAUSE]

These are challenging times to be a leader of any business – and the energy industry is no exception. Our competitive environment gets tougher by the day, and it takes increasing levels of drive and commitment to stay ahead of the game. But, to be honest, that's part of what makes it so incredibly exciting.

Someone once said “You’ve got a lot of choices. If getting out of bed in the morning is a chore and you’re not smiling on a regular basis, try another choice.”

Well, I’m happy to say that after a 40-year career, there’s still plenty to get me out of bed in the morning. This isn’t too surprising given that I have the honour to lead a fantastic team of people at Centrica. And that, in my spare time, I also get to chair the board of Manchester United. Not a bad consolation for the boy who only ever wanted to play professional football.

[pause]

Thank you all very much for listening. And to the Energy Institute, thank you again for recognising me as a worthy recipient of the prestigious Melchett Medal.

It's an honour to be here.

Now, if you'd like, I'd be happy to take a few questions...