Sharing success

How does a high-growth, privately held company compete with industry giants to attract and retain the best people?

JUNO PARTNERS

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In the late 1990s Ky Cao was working for the West Australian government owned power monopoly Western Power, when reform of the industry presented a once in a generation opportunity.

Cao saw the future would be an openly contested electricity market with privately-owned retailers and generators competing for customers, improving service and delivering value.

He left the safety of his job at Western Power to found Perth Energy, relishing the chance to be at the forefront of change in his industry. He raised seed funding from a group of Perth investors and by 2006, the business had revenue of over $8m.

By 2010 Perth Energy had established itself as a leader amongst a small group of commercial providers that competed with the government owned retailer, now renamed Synergy. Cao had also won the support of one of the region's leading infrastructure investment houses, New Zealand listed firm Infratil, which took a majority stake in the company to help fund the purchase and installation of a $130m, 120 megawatt power station at Kwinana, south of Perth.

As a mark of his achievement, in 2011 Cao was presented with the prestigious Ernst & Young Entrepreneur of the Year award for the Western Region.

Attracting and retaining key people

But as new participants followed Perth Energy's lead into the industry and the West Australian mining boom continued unabated, the competition for staff presented Cao and the Perth Energy Board with a new problem: how to attract and retain quality people?

"Electricity and gas supply is a relatively complex industry," Cao explains. "It requires technical and commercial brainpower and experience. To attract and retain good staff and align their interests with those of the company, we needed an incentive scheme that fairly, transparently and efficiently linked company performance to staff bonuses. And it needed to cover short term and long term aspects."

Rod Jones, a director of Perth Energy and founder of the ASX listed global education business Navitas Limited, suggested Cao contact Juno Partners Managing Director, Justin Bown.

"Justin had helped Navitas put in place a profit sharing program that offered a meaningful reward for staff, but only if gains were sustained over three or more years", says Cao. "It had also allowed greater variability in employment costs: up when the business could afford it, but well down and acting as a cushion to profits when the business had an inevitable down year."

Juno Partners was engaged to develop and implement a profit sharing scheme with similar qualities for Perth Energy late in 2010.

"We spent about three months working through all the design considerations with Juno Partners. We discussed a range of options that would allow for rewards to be uncapped, but in a way that ensured only sustained gains were rewarded," says Cao.

Measuring success

An important part of making the program shareholder-aligned was the choice of metric to measure performance. Juno's Justin Bown explains, "Most people come to work each day wanting to do a good job, but every employee needs their manager to clearly define what 'good' looks like."

"Justin asked us to think carefully about how we defined good performance", continues Cao. "Given the capital investment program that lay ahead of us, we chose Economic Value Added (EVA) as the financial metric at the heart of our reward program."

EVA was developed and popularised by US consulting firm Stern Stewart & Co. in the early 1990s. "It's profit as it would be measured by an owner," says Cao, "that is after including a charge for the shareholder's money tied up in the business. Traditional accounting profit charges for the use of the bank's money [interest], but not for the use of shareholder's money. By charging for all the capital tied up in the business, EVA gets staff to think about revenue and expenses but also asset utilisation and working capital management. Other measures like EBITDA don't do that."

Cao had come across EVA earlier in his career and the logic of it appealed immediately. "It clearly shows the value a company creates for its shareholders. Our goal was to share the success we had with our staff in a way that aligned their interests with those of shareholders, so sharing sustained growth in EVA made really good sense."

Owner-like rewards

The 'ValueShare' plan was approved by the Board in February 2011. In addition to the use of EVA, it includes other aspects designed to differentiate Perth Energy in the market for talent and align the interests of employees with those of shareholders.

The plan offers uncapped potential – both on the upside and the downside – but with the safeguard that rewards declared in any one year above a pre-set threshold are deferred and settled over time, provided the employee sticks around and gains are sustained.

The sharing formula is set for three years in advance, providing certainty to the Board and accountability to managers. "I'd seen the crippling impact that tying bonuses to budget could have on the planning process," says Cao. "You're basically paying people to lower their forecasts and game the system. We've got away from all that, again making the culture more entrepreneurial than our competitors."

While the majority of rewards are based on the financial performance of the Group, Cao also wanted to recognise the contribution made by individuals. He retained a small pool to reward outstanding achievement by individuals, allocated annually by him as Managing Director.

"The EVA reward is the bigger number, it rightly focuses attention on how we perform as a team," says Cao, "but the individual reward balances that and allows me to recognise those who have put in a particularly good effort during the year."

To make the most of the change he had led, Cao recognised the importance of education. "Having designed and gained approval for the new program, we wanted staff to embrace it and understand what they needed to do to grow EVA." Juno Partners led education sessions that were reinforced by changes to monthly reporting. Cao continues, "I was pleased to see how quickly people picked up on the principles and the way conversations began to give more emphasis to efficient capital management."

Changes to capex and planning

Changes were also made to the capital expenditure and planning processes. “We began by including EVA in capex proposals and the annual and long term plans we presented to the Board.” Cao says. “And that gave great focus to balancing profit and capital growth. But after a few years we became more focused on the conditions that were necessary for EVA growth.”

“Only about 50% of Australian businesses are profitable from an EVA perspective,” Bown adds. “To grow EVA you have to be investing funds at attractive rates of return, which in turn creates wealth for owners. But because high returns are the path to creating wealth, any business that enjoys high returns usually finds they are quickly surrounded by competitors looking to mimic their offering, but at a lower cost, or with more features.”

“To grow EVA sustainably therefore, you have to think about how to create value for your customers, but you also have to think about how you’re going to defeat the ravages of competition and keep a worthwhile slice of that value for yourself.”

Cao comments, “We started out looking for a way to share our success with our people and we’ve achieved that, but that journey also brought other benefits. It forced us to define clearly what we expect of our people and the company and think through what it is that really drives value for shareholders. It’s been a very useful process.”

A key role in doubling revenue

Cao sums up, “Perth Energy has always been a forward-looking company, not least because we were instrumental to the opening up of the electricity market in WA in the 2000s. This reputation helped us attract high quality staff to the company, which at the time was still a small business.”

“Our retail business grew ten-fold in the five years to 2010 and at the same time our generation arm was in the midst of delivering on time and on budget the Kwinana Swift power station project and soon after a second, $90m, 82 megawatt power station in Merredin, east of Perth.”

“So we had to implement innovative management tools to glide the company's operation into medium sized enterprise mode. The ValueShare scheme was an important part of that.”

“The results from the first 3-year cycle, which paid out in FY12, 13 and 14, show the scheme working well. We are now into the 2nd 3-year cycle and staff have become very familiar with and supportive of the rationale, intent and transparency of the scheme.”

“The introduction of the ValueShare scheme has played a key role in Perth Energy doubling in size to nearly $300m in turnover, without a hiccup on the HR side.”

We are named in honour of the Roman goddess Juno, who as Juno Moneta ('the counsellor'), had a temple on the summit of the Capitoline Hill in Rome that later housed the Roman mint. The peacock is her symbolic animal and the word 'money' is derived from her name.

For further information, or to discuss how we may be able to help grow the value of your firm, please contact:

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