Chairman's Statement

2016 was an extremely challenging year in which Centrica met or beat its targets whilst, importantly, underpinning discipline throughout the organisation on key matters of safety, ethics and compliance.

The impact has been broad with financial delivery, organisational transformation, process efficiency, cash flow and strategic implementation all showing distinct progress. The business re-orientation has been very radical with a particular emphasis on finding ways to enable our people and technology to better understand and serve the changing energy needs of our customers on both sides of the Atlantic.

This process of reshaping Centrica has not been easy or comfortable for our own people and I would like to pay tribute to and thank everyone for their hard work and resilience during the year. Throughout this process, Iain Conn has shown firm, imaginative and decisive leadership. He has chosen his senior team wisely and led them intelligently. They too deserve credit for their performance.

Despite the improvement in our financial position, we took the decision not to resume a progressive dividend policy at this stage. This was a finely weighted judgement. But, in these uncertain times, we would rather err on the side of prudence as further work still needs to be done on strengthening the balance sheet and returning the business to growth.

Our growth plans are clearly shaped with the shift in investment intensity from the resource businesses towards the customer, supporting a focus on building our growth businesses such as Distributed Energy & Power, Connected Home, and Energy Marketing & Trading. We are committed to investing in these businesses, positioning ourselves to compete successfully in a fast-moving, attractive and aggressive environment. We continuously ask ourselves the question 'What will it take to be a winner?' in this new world, and always seek to act to improve our probability of success by adapting our capabilities, technologies and governance as required.

We made strides in 2016, but we are far from satisfied. Our objective is not simply a return to profitable growth for the benefit of our investors, important though that is. Rather we are driven by an over-arching aspiration to become a truly great company.

What does that require, in our view?

Great companies meet a need that is valued by customers and society. And, in doing so, they benefit their shareholders as well as wider stakeholders, including employees, suppliers, partners and communities. And, the most important stakeholder of them all, our customers for whom our clear, resurrected purpose is unequivocally in service; a purpose that seeks to bring a contemporary relevance to a set of values rooted in our 205-year history. And, in that purpose, we are making progress.

Great companies are places where people worry more about what is not working than what is.

Customer complaints are down. But your Board and executive leadership regard any complaint as one too many. Efficiency has improved. But we have suffered a decline in employee engagement. Affordability has improved. But our customers live in a world where incomes continue to be squeezed. And so, we are more consumed by how far we still have to travel than by the distance travelled thus far.

Great companies are places where people think like owners and entrepreneurs, staying viscerally and intellectually connected with the dynamics of their businesses and the forces that shape the operating context of those businesses. And that context, today, is not easy. Business and wealth creation are terms of disparagement. Many reputations have been damaged by the actions of a few. And the positive impacts of globalisation, new technologies and creative investment have been drowned out by the concomitant growth of social inequality.

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Rick Haythornthwaite
Chairman

This poor opinion of business is bad for us, for the UK economy and for prosperity in general. So, we are acutely aware that we not only need to reconnect with our customers. We also need to forge a new partnership with government and our other stakeholders, based on mutual understanding and a willingness to work together.

That is why we welcome the Green Papers on Industrial Strategy and Governance recently published by the UK Government. Government has the power to create a constructive context in which businesses can make the investments which the nation needs.

In the end though, it is businesses, through everyday contact with their customers, which can make the biggest and most immediate impact. The source of real economic and social change is at a local, community level. And that is where companies can be very valuable facilitators of change for the better in people's lives.

Our engineers and technicians visit thousands of customers every week. They are trusted on an individual level to enter people's homes and meet an immediate need, as well as assessing their overall energy requirements.

Our Hattersley call centre on the outskirts of Manchester specialises in helping hundreds of indebted customers every day to manage their energy bills. Last year the proportion of our customers in debt fell and, among them, the proportion on an agreed repayment plan is well above the industry average.

These are just two examples of how we as a business connect with communities and individuals to effect change on the ground. We are close to the real issues and we can make a difference. And we know that we should do more.

It is in these relationships that trust is born, nurtured and thrives.

And great businesses must be built on a foundation of trust, a quality that is in short supply today.

We are very intent on rebuilding trust in our company and sector.

This requires not only an emotional and physical investment in our relationship with our customers and society but also the addressing of the prevalent impression that UK governance in general is failing, an impression that will render any such investment worthless if untreated.

In fact, there is a strong case to be made that the UK has the best corporate governance framework in the world.

The answer to any breakdowns in UK governance lies not in further embellishment of that framework but in promoting better compliance and a collective commitment to resolve some of the more intractable and sensitive issues over time.

Foremost amongst those issues is executive remuneration, often the lightning rod for criticism of boards. We are making progress over time. Long term executive pay trends are shifting towards more simplicity, lower differentials and internal succession in preference to expensive 'star signings' from outside. The responsibility lies with chairs and boards of directors to manage the balance between addressing this perniciously divisive problem and avoiding the unintended consequences that precipitous change, though perhaps politically popular in the short-term, may carry in terms of weakened capabilities and competitiveness. More regulation is unlikely to provide the answer.

In respect of compliance, your Board is continuously seeking ways in which we might better comply with and apply the Code. That must always start with recruiting the best possible directors whose track record speaks to their credentials, wisdom and professional approach. The quality of a board ultimately flows from the sum of these attributes; perhaps the setting and policing of standards in this key determinant of good governance holds the key to improving global standards rather than further embellishment of the Code.

We have worked to enhance our governance structures and processes throughout the year. Full details of this activity is set out in the Governance section on pages 65 to 82, but it is the ongoing, deliberate refreshing of your Centrica Board that holds the key.

During the year, we reviewed the succession plans in place for the Board and the Executive. We identified digital, retail, North America and financial services as areas of business experience and expertise where the recruitment of new Board members could complement the strengths of our existing Board. We also paid heed to the public concerns about the extent to which the voices of customers and employees were being heard in the boardroom, bolstering our agendas and approaches were necessary.

There were several changes to composition of the Board. In June, Stephen Hester was appointed as a Director of the company and, in October, he succeeded Ian Meakins as Senior Independent Director. Stephen has wide-ranging commercial experience, particularly in customer-facing businesses.

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In addition, he brings a broad understanding of financial services, together with a deep knowledge of operating within highly regulated businesses. I would like to thank Ian for the great contribution he has made in his six years' service on the Board.

Scott Wheway joined the Board in May. Scott has a wealth of experience as a senior customer-facing business leader with a mix of deep retail and consumer expertise. He is also a seasoned remuneration committee chair and will assume that role for Centrica following the 2017 AGM. Joan Gillman was appointed as a Non-Executive Director in October. Joan is former executive vice president of Time Warner Cable, the second largest cable company in the United States, and has wide experience in media, communications and the shaping of network technology strategies. Scott and Joan are both valuable additions to the Board and are already making their contributions felt.

During 2016, the Centrica leadership did a great deal to put in place the diverse teams, structure and technology required to underpin our growth and give us a competitive advantage in our chosen markets. Centrica has moved a long way in 12 months. We may have 'What does it take to be great?' as a constant challenge but equally we never lose sight of the question 'What do we have to do to make a difference now and make this future possible?' It is thanks to this healthy combination of aspiration and practical application amongst our executive team that your Board looks to the future with growing confidence.

Rick Haythornthwaite
Chairman
23 February 2017