The relationship between utilities and their customers in the current economic downturn could fundamentally change, becoming more remote and thus limiting profitable growth opportunities…

<u>Risks to Utility Customer Relationships from the Economic Slowdown</u>

A little over a year ago, the challenges facing the global Energy and Utilities market were driving a significant wedge between utilities and their customers. In western European markets, price increases across gas, electricity and water, combined with increased corporate earnings left many utilities in the uncomfortable position of being seen as profiteering from customers unable to change suppliers for significant benefit. Headline-makers had a field-day, with gross-simplification of the business models used by many utilities that gave the public a distorted view, claiming "obscene profits"[1] while citing the "long-suffering" consumer position. Now, more than a year later, prices of gas and electricity are falling, but the severity and pace of the wider economic downturn has given no time for utilities to re-position themselves with customers. Brand and relationship-enhancing programmes such as smart metering and energy efficiency programmes are still largely in their infancy.

The evolving relationship with the customer base, where customer expectations are driving a more participatory, multi-channel engagement, comes at a time when the evolution of smart networks and metering solutions are on the cusp of driving down cost to serve while improving service levels and options for customers. Significant benefits accrue from the consumption measurement and management capabilities, and from the opportunity to transform the consumer relationship, pushing into new areas such as home device management, more personalised tariffs, easier debt arrangements etc. The position for utilities, therefore, should be favorable – finally being seen to be working on a more participatory relationship with their customers.

For consumers, the consequences of recession include an increased pressure on household spend. In competitive markets, there could be increased churn as the ever-changing "best-buys" attract customers. For utilities, increased churn rates are obviously bad news – the cost of acquisition of a new customer often wipes out profit associated with consumption by that customer for months, even years. Moreover, while utilities are working on marketing the best deals to acquire and retain customers, and on piloting smart technologies in the home, the consumer's familiarity with new technologies and their allegiance to some brands will allow a window of opportunity for third parties to gain greater hold on the customer relationship.

Take the case of smart metering, for example, where many utilities are engaging upon pilot and larger rollouts. This is an area of innovation that should deliver benefits to both consumers and utilities. The assured business benefits to the utility companies come not only from applying the technology to lower operational costs, but also from enhancing their brand and customer

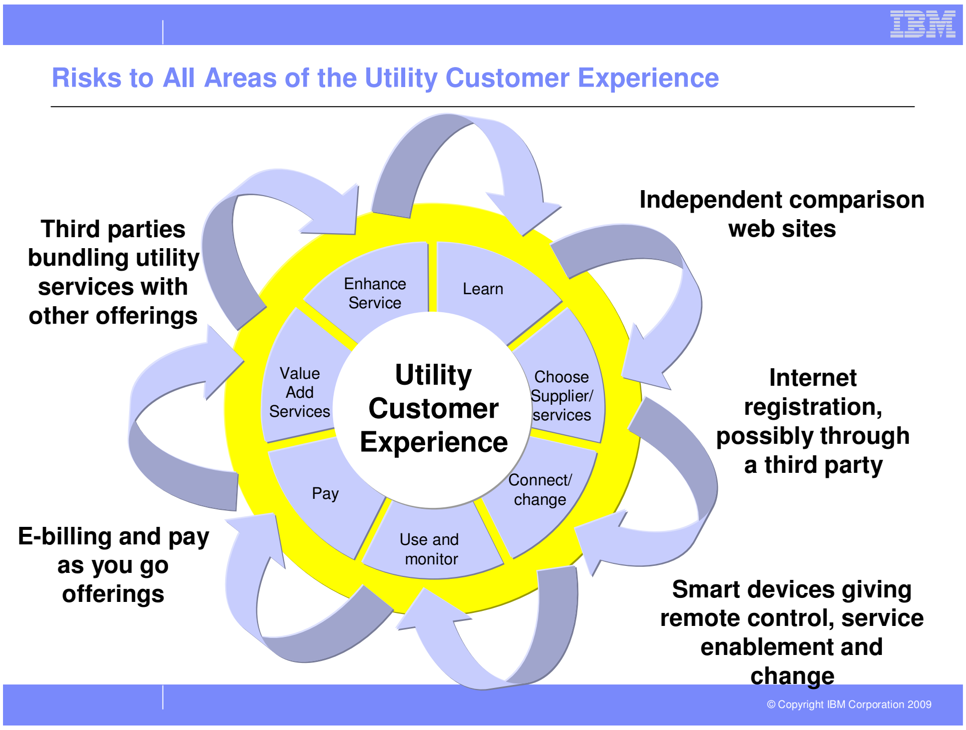
[1] Many references, especially in the British press including: http://www.energysavingtrust.org.uk/Resources/Daily-news/Gas-and-Electricity/Probe-demanded-into-energy-rip-off/(energysavingtrust)/20792

service reputation. To the customer, smart technologies offer consumption details in understandable form and give the promise of accurate commodity billing.

The risk is that the potentially lucrative relationship between customer and utility is currently damaged to a point where telcos, retailers or technology companies could step in with attractive, multi-service offerings, relegating the utility to simple supply activities, unable to gain a significant hold in the home engagement. Certainly, utilities will still witness savings from Automated Meter Reading and improved billing accuracy, but this commoditisation path for the utility company will limit profitable growth and push utilities further away from their customers. Combine this with increased churn, and suddenly the benefits of smart technology deployment could be wiped out for the utility company.

This is not just an issue associated with smart technologies – the entire customer relationship journey with a utility is under threat from non-utility entrants. Consider the area of consumer marketing and sign-up. Third parties that simply market other company's services have already taken a position in this part of the customer journey by providing Internet sites that allow tariff comparison and online switching of suppliers. The brand awareness of the comparison sites has already begun to gain the trust of the customer and the utility brand becomes more remote – the start of an uneasy decline. Additionally, in receiving fees for bringing customers to utilities, these companies thrive on churn – driving up utility cost and driving an even greater gap into the consumer-utility relationship.

Further credence to the challenges comes in the areas around presentation of information to customers. Any utility information channel will demand attention to "stickiness" when using technology such as the Internet for displaying utility bills and consumption data. This information has to be pushed to consumers in an attractive, understandable and, above all, personal format. Does the traditional utility information quality and flow has enough appeal for the average consumer to repeatedly view over time? It could be argued that third parties have the ability to blend in more diverse information to improve stickiness on, for example, hand held devices, that give the consumer other benefits such as telephony, traffic, weather etc.



[Suggested title: "Risks to the Utility Customer Experience"
Traditionally, utilities are seen as relatively "recession proof", operating on longer-term cycles than financial and retail markets. It is this long-term view that, coupled with an already disjointed customer relationship, poses a significant risk to utilities in the next two years. Customers will react in the competitive markets to the feeling of being 'cornered' in an environment where few utilities truly differentiate themselves on customer service, product, tariff or brand. Research suggests that consumers are driving change in the relationship with their utilities and it is this change that opens up opportunity for others ("Plugging in the Consumer", IBM Institute for Business Value, 2007).

Reaction may not come soon; rarely do new entrants come into a recessionary market, but the potential for non-utilities to begin to exploit the gap between customer and utility should give cause for concern.

The parallel of these changes and risks was seen in the telco landline market over the last two decades. Several of the big former-monopoly landline carriers are now perceived as commodity bandwidth providers, with declining core customer numbers and often-difficult regulatory challenges. Newer, more agile companies have stepped into the role of "owning" the consumer relationship and tailoring the commodities into appealing packages. The underlying services may well still come from the former-monopoly, but the customer relationship is now skewing toward the new entrant.

There are strategies that can be proactively deployed, individually or in combinations, that improve the resilience of a utility through a recession, and indeed that re-draw the client relationship to the point where profitability can increase without attracting the appearance of excess. These strategies resist the potential demise of the utilities to commodity providers, allowing for a value-add future based on their pervasive presence in the home.

The steps outlined below revolve around the need to focus on the fundamentals, essentially customer relationships and cash:

1. Know your customer

Like most companies, utilities can benefit greatly by knowing more about their customers. By engaging upon a strategy of ongoing information collection, customer segmentation and profitability analysis, plans can be put in place to detect and react to the risk of customer attrition. This includes the early identification of changes in a customer's circumstances, such as the ability to settle debt, allowing the utility to work proactively with the customer to address the issue. This more active relationship style will show consumers that utilities care and understand, increasing brand loyalty and hence lowering the cost to serve.

2. Free up locked cash

Although recession-resistant in the short-term, identifying organic sources of improved cash flow can be an important source of funding for utilities which need to invest in improving customer relationships and capabilities. Industry benchmarks indicate that most utilities have opportunities to plug leakage in their working capital processes, with the potential of tapping into a significant and accessible source of free cash flow. For example, consider the traditionally neglected, under-invested area of consumer debt. With the economic downturn, debt levels are likely to rise, and, if unchecked, costs and cash flow will be adversely impacted. Focus areas for addressing the issue and freeing up locked cash include:

- Using process management techniques such as Activity Based Management or Lean Six Sigma to identify opportunities for performance improvement across the billing, collections and credit management processes;
- Focusing on developing the skills and operational structures required to better integrate the meter to cash functions;
- Optimising the use of utility-specific debt tools that work with the core systems.

Additionally, gaining insight through precision analytics to better manage debt functions, similar to best practices in banking and telecommunications needs to be accelerated.

3. Focus on the future

Cost cutting is inevitable by many companies in this economic environment. It is important to understand the medium- to long-term impact of any cuts on the customer relationship, to determine if they could have a detrimental impact on profitability by increasing churn and related cost-to-serve metrics. Thus, utilities must achieve a clear understanding of their baseline performance, and have a predictive decision-making capability that delivers accurate, real-time insights so they can be confident that any actions taken will yield the best results.

4. Innovate

Utilities traditionally work on longer investment cycles than many other businesses and, when compared to consumer-facing industries, can deliver a perception to the consumer of lacking innovation. Many consumers readily accept new offerings from retailers, telcos and technology firms, and the promise of a smart home will clearly be of strong commercial interest to these individuals. Utilities must act now to show how they are changing, innovating for the future and putting control into the hands of the consumer. Smart metering programmes will begin this process of re-positioning the utilities as innovators, but the key will be to use the technology in a manner that bonds the customer better with the utility.

5. Agility is King

The longer investment cycles in the utility sector, combined with the massive scale of operations and investment, often restricts the ability for utilities to be agile in their business models. The long-term future of many utilities will depend on being able to react to new consumer, technology and regulatory demands within short timescales. Innovation is only innovative for a short time –businesses need to be ready to embrace and exploit innovation with new business models.

Many will argue that the current utility programmes of change such as core system replacement, smart metering and improving customer offerings, will be enough to sustain and even enhance the customer relationship. The real benefit, however, will be from building upon the change, moving into new products, delivering personalised services and tariffs, and demonstrating an understanding of the needs of the consumer individually. Utilities may struggle to capture discretionary spend from customers ahead of telcos, retailers, financial firms and others. Simply put, action needs to be taken now to prevent the loss of long-term customer relationships. For utilities, doing more of the same in this dynamic and changing market may simply not be good enough!

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