A different way of doing business
Digital in utilities
“The impact of digital on traditional utilities has parallels with the impact of the internet on high street retailers in the early 2000’s. There will be those organisations who view it through the lens of their existing business processes and transactions, and there will be those who see the potential of a different way of doing business”

Richard Postance
UK&I Customer Strategy Partner, Ernst & Young
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A different way of doing business

Energy retail companies have traditionally been operating in a low margin, commoditised business largely insulated from the pressures of competition because of the high barriers to entry. But digital technology, and the changes in consumer behaviour and expectations which accompany it, coupled with increased regulatory pressures, are set to change that business in fundamental ways.

Key findings
► Utilities have the chance to re-invent themselves
► Energy suppliers need to gain customers’ confidence
► Community-based customer care, provided through digital technology
Utility suppliers face three new realities which are forcing them to reassess their positioning for the future.

The first is the growth of generations X and Y who will account for 50% of the UK workforce by 2016. These customers have enthusiastically embraced technology such as mobile internet and social networking which enables them to be connected 24/7. According to the International Data Corporation’s quarterly mobile phone tracker report, vendors will ship a total of 472m smartphones in 2011 compared to roughly 305m units shipped in 2010. That figure will nearly double to 982m by the end of 2015.

On demand access to the digital world means that this segment of customers has very different expectations:

► They learn through collaboration and networks – the average Facebook user spends 55 minutes on the site daily.
► They expect options and make decisions based on peer recommendations – 78% of consumers say they trust peer recommendations, compared to 14% only for advertisements.
► They are constantly giving their opinions and view on products, services and brands online – there are over 1500 blog posts every 60 seconds, and 34% of bloggers post opinions about products and brands.

Secondly, energy suppliers’ share of the household budget is relatively small and margins are being squeezed. According to the Office of National Statistics, energy and fuel accounts for only four percent of the average UK household spend of £455 per week.

The need to make substantial investment in new forms of generation and infrastructure to meet aggressive carbon reduction targets, coupled with Ofgem’s increased efforts to stimulate greater competition, are adding to the pressures on margins, while at the same time utility companies are facing competitive threats from new businesses targeting their customers.

Comparison websites offer a way to compare utilities’ tariffs and share recommendations via simple web interfaces. Their focus is on saving money by switching energy provider, and in doing so these websites are taking the customer relationship away from the suppliers. A survey for Ofgem conducted by Ipsos MORI identified internet access as a key factor in switching, with 27% of respondents using online comparison sites, and more than half of those switching doing so more than once.

Finally, technology such as smart metering offers suppliers a way to understand customer usage patterns and needs better and to use that knowledge to develop new products and services and expand into new markets.

At the entry level, smart metering is designed to improve the transparency and understanding of energy usage. But combined with other technologies, smart meters have the potential to become the hub that brings together connected assets in the home.
Figure 1: Changing demographics (source: Ernst & Young Research)

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<thead>
<tr>
<th>Generation Type</th>
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<tr>
<td>Generation Y</td>
<td>33%</td>
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<td>Traditionalist</td>
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<td>Traditionalist</td>
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New opportunities to grow

By using digital technology to become more innovative in their customer propositions and improve their brand perception, energy companies could enter markets that represent as much as 22% of household spending – much of this at margins far greater than their core energy market, according to calculations by Ernst & Young.

Customers who use smart metering initially to understand their energy consumption – and reduce their energy spend – may be willing to move on to purchasing additional products and services in and around the home designed to help them save money or to provide additional support.

In the first wave, smart technology will be used to monitor home energy usage, to trigger alerts when previously established maximum limits are being reached, and to offer ‘time of use’ tariffs that reward consumers for shifting demand from peak times. Following on from this, it will become possible to connect home appliances to a smart network so that they can be controlled and monitored remotely. In time, the scope of the smart home network and the portfolio of services available will expand to include security systems, electric vehicle charging and micro-generation management, and ‘intelligent’ home energy management systems that auto-select the best tariff will emerge.

Digital technology gives utility companies the opportunity to add new services and also to change the way customers buy their products. By adding in social networking tools such as group buying sites, providers open up options for ‘community purchasing’ of energy services tailored to specific user needs.

Sites like Groupon (which has over 35m registered users) and its imitators generate revenue through commission from the underlying retailer, once a certain volume of products or services are sold to consumers.

Utilities could capitalise on this and the wider trend for location based services, by bypassing the social networks and offering energy deals direct to either local or virtual communities. This facility could be offered alongside micro- and distributed generation services as a one-stop shop for green energy at low cost.

Previous attempts by energy companies to move into adjacent markets have generally been unsuccessful. However, with digital and smart technology, utilities will have much richer, customer-level data on which to build new propositions which could include bundling a range of home services together.

A key benefit of this approach is the opportunity it gives utility companies to build up customer loyalty – using a comparison website to switch energy supplier may become even easier in future, but will consumers want to make a wholesale change to their energy services provider?
**Figure 2: Weekly total household spending (2009) addressable**

- **Non-addressable**: £360
- **Addressable**: £109

- **22%** (Addressable)
- **78%** (Non-addressable)

Source: Office for National Statistics and Ernst & Young analysis

**Figure 3: Addressable weekly household spending by category for energy companies**

- **Vehicle purchase and maintenance**: £109
- **Utilities (water, gas, electricity, other fuels)**: £25
- **Financial services and insurance**
  - Communications (telephone, broadband)
  - House appliance purchase, care and repair
  - Other maintenance and repair
  - Home entertainment (e.g., Sky)
  - Home security

Source: Office for National Statistics and Ernst & Young analysis
A different way of doing business

Digital in utilities
New competitors and challenges

The critical issue for utilities is how they manage the introduction of smart metering, given their often patchy record on customer service. Customers have become used to interacting with other companies in more efficient, streamlined ways using digital technology, and those retailers are poised to exploit the data they have collected on customer behaviour to move into this new market. At the same time, price comparison websites have moved customers further away from the energy suppliers, who they trust less than they do the information they research online or via social media.

Smart metering allows energy retailers to collect information on customer usage and respond with targeted value propositions. But it denies suppliers the opportunity for ‘moments of truth’ when they provide exemplary customer service, because smart monitoring will reduce unplanned, emergency incidents and automated bills will mean less customer interaction.

The underlying technology allows for a ‘plug and play’ approach, which will also reduce the barriers to entry to the market for home hub services. This opens up possibilities for companies who are experienced in using digital technology to build good relationships with consumers – witness the recent launch of Cooperative Energy, where the retailer is seeking to exploit widespread trust in their brand to expand the range of services they offer. Digital businesses which specialise in data analysis and in tracking customer behaviours are also likely to be considering this market.

Figure 4: Consumer perceptions of energy providers are poor

Consumers define their relationship with their energy supplier as purely rational. They sense a strong imbalance of power – big company versus small, insignificant consumer. The image of P&Us is influenced by their history as monopoly businesses.

- Lack of change and innovation: only one single basic offer
- Lack of flexibility: no room for negotiation when dealing with client requests
- Little and one-way communication (currently just sending the bill)
- Lacking transparency, no information or education
- Remote, distant, unapproachable
- Untransparent bills and tariffs
- Bureaucratic processes
- High tariffs, additional costs, increasing prices
- Lack of choice and differentiation in suppliers’ offers
- Consumers feel like captive customers
- No incentives
- Poor customer service in some markets

A different way of doing business Digital in utilities
The investment required for smart technology and the accelerating take up of digital technology present utility companies with difficult choices. For those who do not plan to utilise smart as an opportunity to improve their financial performance, or who doubt their ability to succeed in this market, the resources required could add weight to the argument for divestment.

For others, there is the option of using digital to make tactical improvements to their existing business, by streamlining operations and reducing the cost to serve and cost to acquire, and to get closer to customers. Meridian, a New Zealand energy company, is using the advantages of digital to capture the online market. It launched PowerShop, an online energy retail market place that gives customers choice and control over how much power they buy and use. For Meridian the benefit of this innovative channel is it attracts online consumers and extends the reach of its core retail offering.

Finally, there are those utilities who will identify digital as the way to transform their business. They will create competitive advantage through digitally-enabled cost effective operations, expand their scope of services to new markets, and use the smart meter as a platform to gain further traction in the smart home of the future.

Utilities have the chance to re-invent themselves, by building a strong customer focus and innovating a new portfolio of products. The challenge lies in competing with companies who are more experienced in the digital market and who have brands which resonate more strongly with consumers.

Energy suppliers need to gain customers’ confidence through empowering them with digital technology and by doing so open up the possibility of gaining a bigger share of customer spending at a time when the margins on their traditional business are being squeezed and regulation is tightening.

Community-based customer care, provided through digital technology, offers utilities both cost-to-serve efficiencies and improved customer intimacy; crowdsourcing, online forums and wikis all offer ways for companies to learn about customers’ views and buying behaviours, at the same time as improving brand engagement and loyalty. In addition, instant messaging and mobile applications extend the concept of self-service by allowing people to book appointments or analyse energy consumption patterns in new, easily accessible ways.

How can utility companies respond to digital developments?
Ernst & Young professionals understand the global impact of smart technology as well as specific issues in national markets. Our objective is to help you make appropriate decisions by providing sound, independent and unbiased advice. We have the experience and capabilities to help P&Us control risk, reduce costs and unlock customer value throughout the whole smart metering journey.

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<tr>
<th>Strategy</th>
<th>Key issues and challenges</th>
<th>How Ernst &amp; Young can help</th>
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<tr>
<td>Business as usual</td>
<td>► Achieving a minimal level of customer involvement</td>
<td>► Defining your customer proposition</td>
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<td></td>
<td>► Preventing customer resistance</td>
<td>► Improving operations through customer and market segmentation, customer service effectiveness and customer service processes</td>
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<td></td>
<td>► Fulfilling regulatory and legal requirements</td>
<td>► Communication and marketing strategy or planning</td>
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<td>► Delivering pilot projects and rollouts successfully</td>
<td>► Supply chain management</td>
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<td>► Performance improvement</td>
<td>► Project management</td>
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<td>Customer-focused strategy:</td>
<td>► Fundamental changes to business strategy</td>
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<tr>
<td>► Strengthening existing business capabilities</td>
<td>► Establishing trusted and strong customer relationships</td>
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<td>► Joint ventures and partnering</td>
<td>► Achieving customer engagement</td>
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<td></td>
<td>► Make-and-buy decisions in customer-related areas</td>
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<td></td>
<td>► Identification and selection of potential joint venture partners</td>
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<td>► Implementing joint ventures</td>
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<td>Exit strategy</td>
<td>► Stakeholder management</td>
<td>► Defining exit strategies</td>
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<td></td>
<td>► Carve-out issues, including separation of IT or other shared services</td>
<td>► Identifying potential buyers</td>
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<td>► Getting the best price for the retail business</td>
<td>► Vendor due diligence</td>
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<td>► Carve-out</td>
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A different way of doing business

Digital transformation

For energy suppliers, there is no time to waste. The timetable for smart technology will soon require large-scale investment, and forward thinking players will already be plotting their course. The opportunity presented by digital is there for the taking, the question is can utilities, with their legacy business models, now take advantage of the new reality?

For today’s consumers, digital technology is mainstream, as their accelerating adoption of online connectivity and social media demonstrates. With new entrants keen to enter the market, and smart metering offering them a way to do so, utilities are facing a last chance to innovate and stay ahead. To be successful, energy companies have to show they can change how they operate, switching from being an ‘energy supplier’ to an ‘energy services provider’.

How is Ernst & Young positioned to help?

Please contact Richard Postance (rpostance@uk.ey.com), Yunus Ozler (yozler@uk.ey.com), Simon Cox (scox2@uk.ey.com), Karl Havers (khavers@uk.ey.com) or Ritesh Arora (rarora@uk.ey.com) at Ernst & Young if you are interested in further exploring our digital offerings. We would be happy to assist your organisation in identifying digital opportunities across customers, suppliers, investors, leadership and employees.

Notes

1. IDC Worldwide Quarterly Mobile Phone Tracker, June, 2011
5. Universal McCanns International Social Media Research Wave 3 Q1 2008
The digitisation of everything

Social media

Digital data opportunities

For more information about our views on Digital and to see more, please contact your local Ernst & Young office or visit www.ey.com
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