Capgemini Consulting

European multi-client retail mass market benchmark

Key findings from 2010 edition

Contents

Introduction

This document provides some general results of the 2nd edition of the European multi-client mass market benchmark and highlights the value delivered to participants.

First, we would like to thank all the participants of this benchmark who made it a success through their active involvement. Fifteen participants out of 17 candidates provided enough data to analyze their complete Service, Acquisition and Marketing Costs for electricity and gas retail in the household B2C segment for 2009.

Many companies in our sample offer dual fuel: seven participants have more than 20% of dual fuel contracts (up to 77%), six have less than 5% of dual fuel contracts and two have only gas contracts. Customer portfolio size is another criterion of differentiation in our sample. We have created two peer groups based on size: eight retailers are below 1 million customers and seven above 1 million customers.

Our benchmark focuses on retailers' operating expenses

The benchmark analyzes the total cost of retailers' operations split in three parts: **Cost to Serve (CtS), Cost to Acquire (CtA)** and **Marketing Costs** (see Figure 1 and box on benchmark methodology for further details).

We deliver specific detailed conclusions to each participant highlighting their own position and analyzing their specific levers for improvement. In each benchmark report to participants we:

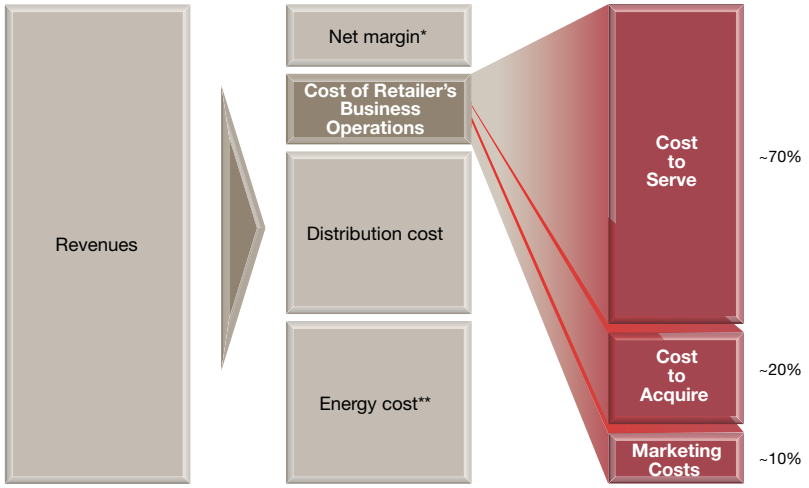
- give visibility on their current situation and provide precise explanations to the profitability and customer switching issues that have been observed
- assess the performance potential of the retail organizations compared to the best performers in their peer group and identify possible levers to improve efficiency
- determine achievable goals according to the market and regulatory context and the retailer's specific situation.

For confidentiality reasons, none of these specific conclusions is included in this document, even anonymously.

In this document, after a short presentation of participants' market context, we highlight the main findings about:

- CtS which represents the main component of operation costs (70% on average)
- CtA and Marketing costs which are key indicators of sales effectiveness.

Figure 1: Main components of cost breakdown model



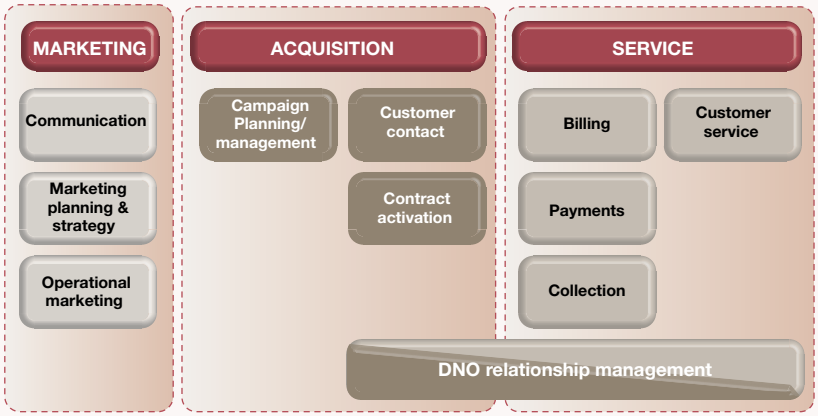
* EBIT (Earnings Before Interest and Taxes)
** Includes imbalance and pass-through costs
Source: Capgemini

Benchmark methodology

The analysis includes three steps:

1. Identify and calculate the Costs of Retailers' Business Operations using profit and loss (P&L):
   - operational cost (Full Time Equivalent (FTE) and outsourcing costs)
   - bad debts (only for CtS)
   - IT costs
   - other costs (overheads and other costs)
2. Allocate by activities (marketing, acquisition and service) and analyze these costs by processes as shown in Figure 2.

Figure 2: Process view



Source: Capgemini Consulting benchmark 2010

3. Allocate and analyze these costs by channels:
   - call centers
   - Web, direct mails
   - retail outlets, retail partnerships
   - reselling partners, sales representatives or contractors.

The main keys to allocate costs by activities, processes and channels are: number of employees (FTEs), number of contracts, number of calls or contacts and number of documents.

Besides, the study used the **PPP index (Purchasing Power Parity)** in order to balance the price levels between different countries. This index is used for most international comparisons like Gross Domestic Product, labor cost, health care costs, and R&D expenditures.

Market context of benchmark's participants

Competition is increasing

Competition within the electricity and gas retail markets is increasing

Generally speaking, 2009 has shown a greater activity in customer switching in Europe with some countries becoming active markets. For example, Ireland, which was barely a dormant market, became first in terms of customer switching, ahead of Great Britain that was constantly at the top of the previous ranking. Denmark has also demonstrated a greater activity, tripling its switching rate in 2009. The economic recession prompted customers to look for cheaper offerings but this is not the only driver for customer switching. Other mandatory drivers are effective public information and marketing campaigns together with regulators' measures.

Despite these examples, competition is still moderate in most countries (for instance Germany and France showed stable rates at around 5%) while some countries have a switching rate above 10%. Still hardly 50% of the EU-27 can be described as dormant markets with switching rates below 1%.

All benchmark participants belong to moderately active markets

This year, all participants belong to active markets with moderate competition (see Figure 3). Most of them are affected by competition but only a few of them are fully engaged in the race. Some participants are still unaffected, but are very worried by increasing competition in the future: they show high interest in measuring their effectiveness.

Prices are almost stable and margins are low

Regulated tariffs are still widely spread across Europe

In the electricity and gas households segment, regulated tariffs are still in place in 15 out of 27 Members States. The persistence of regulated prices prevents competition to effectively grow. Electricity prices for residents stayed flat overall in 2009. Only a few countries (such as Belgium and Italy) have forced electricity price reductions to preserve customers' power purchasing in the context of the economic crisis. Gas prices decreased by 12% in H2 2009 compared to H2 2008. And in H1 2010, electricity prices increased slightly (+2% compared to H1 2009) and gas prices remained stable.

Most benchmark participants operate with low margins

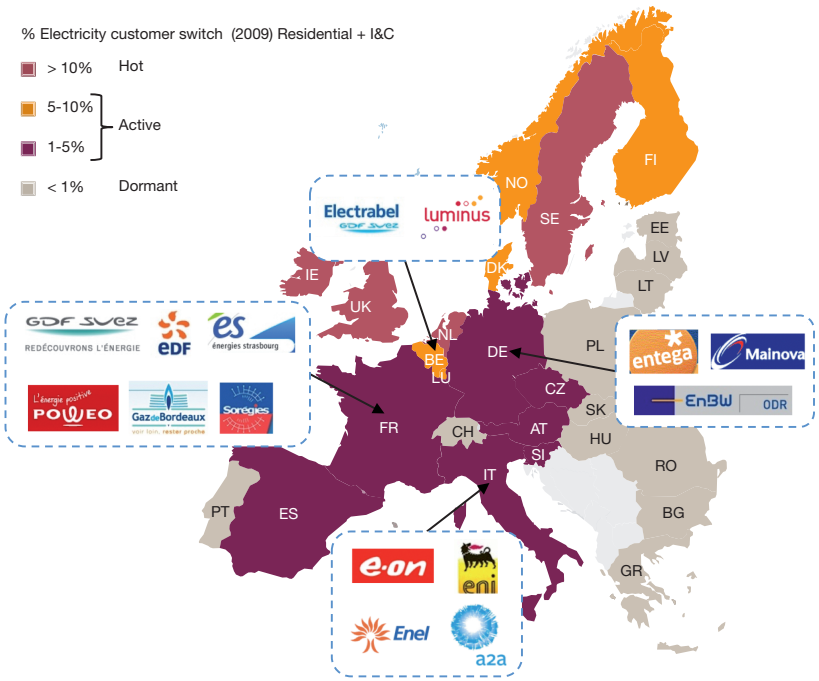
In the 2nd edition of the European multi-client retail household benchmark, the participants exhibit low net margin with an average figure of €2.6 per contract (median figure: €10.3 per contract). However, only two thirds of participants provided enough information to calculate margins.

Electricity and gas retailers have no control of distribution costs (that are regulated) and have already engaged strategies to optimize their energy costs. If they want to increase or at least keep their margin at their current level, they have to better control their costs of business operations.

Costs of Service, Acquisition and Marketing are hot topics

Analyzing and identifying levers to better control costs and therefore improve the efficiency of processes and organizations is critical for retailers. We consider that CtS, CtA and Marketing Costs are key drivers of retail Utilities' profitability, especially on the household market where a single customer can yield a very low gross margin per year.

Figure 3: List of participants and aggregated switching rate



Source: VaasaETT switching categories & Capgemini Consulting benchmark 2010

Cost to Serve is key to ensure profitability

Analysis of CtS shows heterogeneity of performance levels

There are important differences of CtS among participants: values range from €14.9 to €51.4 (excluding extreme values) with a median value of €32.4. Retailers with more than a million customers perform slightly better than smaller ones. But to a broader extent, 80% of the sample has a CtS above €16 (value of best performers) which raises questions about their performance levels.

CtS increased compared to the first edition (average CtS by contract raised from €26.3 to €35.7) for the following main reasons:

- between 10 and 20% of the increase is due to IT, overheads and other costs. While analyzing changes over editions with some participants, we confirmed that this year questions enable a more complete picture of Cost of Business Operations
- the economic crisis led to a harsher economic climate and more bad debt for most retailers
- investments in IT: in Germany (and to a lesser extend in France) retailers have been forced to separate systems to comply with EU unbundling legislation for retail and distribution activities. This required high investment driving up CtS.

These factors have dramatically weighted on some participants' CtS in 2009: the bad performance of these participants explains 50% of the CtS increase compared to the last edition.

Best performers manage to have low costs on all components of CtS

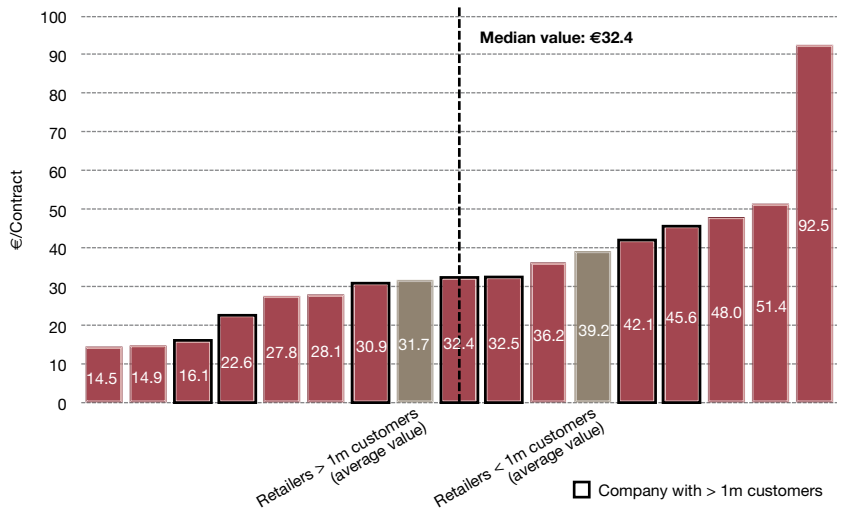
Keeping all four cost components (operational costs, IT costs, bad debts and others costs) under control is mandatory to have a low CtS. Every retailer which fails in at least one of the four components is ranked poorly.

Operational Costs is the main component of CtS and is correlated with the overall CtS performance. As labor and outsourcing costs represent a very significant part of it, operational costs are highly sensitive to channel and process optimization. We found out that outsourcing can lower CtS only over a threshold of ~700,000 contacts as below this threshold the additional complexity in management seems to increase CtS.

Overheads and IT are the only components sensitive to economy of scale

The size of retailers (i.e. number of customers) does not impact CtS as much as one could expect. Retailers with over 1 million customers have a lower CtS (€31.7) than those below the 1 million mark (€39.2) but this difference is only on "Overheads and other costs" and to a lesser extent on "IT costs" where large retailers have better economies of scale.

Figure 4: Cost to Serve per contract (corrected with PPP index)



Source: Capgemini Consulting retail benchmark 2010

There is no size effect on operational costs by contract or on bad debts. These two components can be compared across the whole sample. Process efficiency is not related to the retailer's size.

The proportion of unaffected costs (overheads and other costs) is lower than last year, as the 2010 model allocates more precisely a larger share of costs.

The main lever to lower CtS is about increasing customer satisfaction

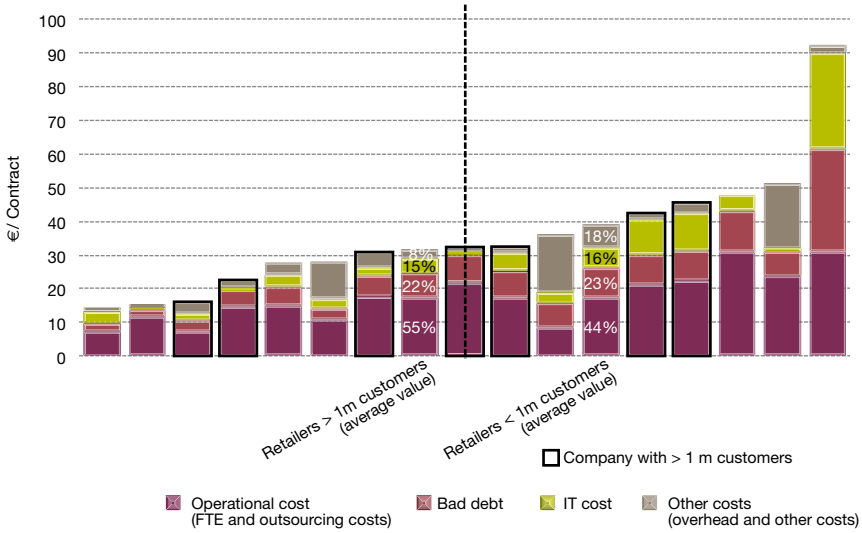
Capgemini Consulting produces a customized synthesis specifically for each participant highlighting the possible levers to improve CtS performance and proposing possible projects. Results are based on numerous elements such as:

- process view
- billing method and frequency
- payment and collection method and frequency
- number of inbound calls per contract
- average call handling time
- percentage of answered calls.

The main finding is that low customer satisfaction corresponds to high CtS. Inconsistent processes produce poor quality data which lead to inaccurate bills or documents which trigger calls, complaints, payment and collection issues and at the end of the day bad debts and churn. High-performing retailers know that CtS, customer satisfaction and churn must be handled in a holistic approach.

For instance, many participants are pursuing a strategy of First Call Resolution to limit the number of contacts per contract. The limited correlation between the level of First Call Resolution and overall performance in CtS shows that this strategy helps but is not enough to have a low CtS.

Figure 5: Cost to Serve category view per contract (corrected with PPP Index)



Source: Capgemini Consulting retail benchmark 2010

Meter reading, billing and payment strategies impact CtS performance

Another finding is that, within the sample, different models lead to low CtS which proves the absence of a single model to be applied to every retailer. Different billing, payment and collection schemes combined with a different channel mix can lead to low CtS provided they guarantee customer satisfaction in their company situation and local market context.

Customer service accounts for more than half of the total CtS. Comparison between participants of different countries shows how meter reading, billing and payment strategies have a strong impact on CtS:

- benefits of smart metering are obvious in Italy where it represents a large part of electricity meters. Smart Metering allows high billing frequency using actual consumption, thus avoiding the problems commonly encountered when using estimates which generate calls. This shows that using actual consumption is a more powerful lever to lower CtS than reducing billing frequency
- self meter readings combined with a high frequency of payments using direct debit, as favored by German participants, produce better results than a combination of estimated bills and annual bills with monthly direct debit, as favored by most French participants. This shows that having fixed monthly payments combined with actual billing is another powerful lever to lower CtS.

There are three main areas of improvement for retailers

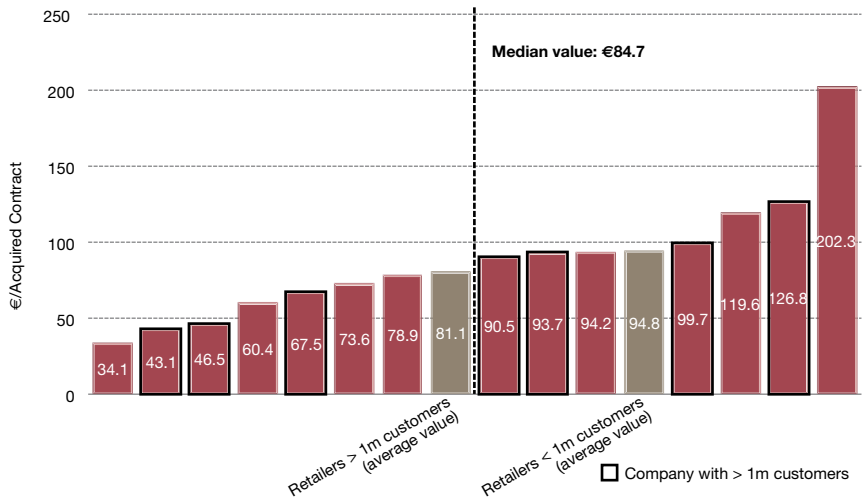
We believe that most retailers are working on or should work on:

- process and IT optimization, lean approach or other similar methods to reduce CtS
- multi-channel optimization to lower CtS and CtA
- customer loyalty and churn reduction.

We know that there is no unique answer to the tricky question "where to start first?". Through our benchmark, we help retailers to answer this question and set priorities because benchmarking is a powerful tool to find out or confirm where the main areas of improvement are for each retailer.

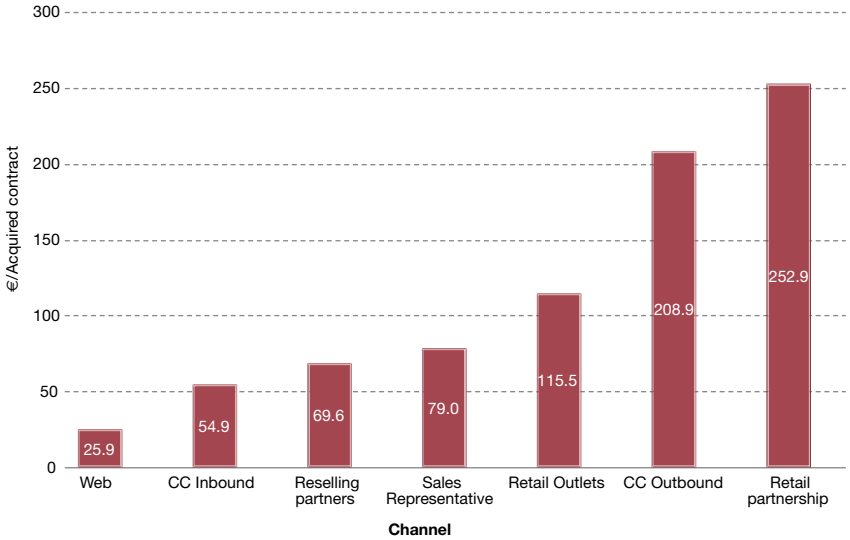
Cost to Acquire and Marketing Costs are the key metrics of sales and marketing efficiency

Figure 6: Cost to Acquire per contract (corrected with PPP index)



Source: Capgemini Consulting retail benchmark 2010

Figure 7: Median cost by acquired contract per channel (corrected by PPP Index)



Source: Capgemini Consulting retail benchmark 2010

CtA results show great heterogeneity in sales strategy and channel mix of participants

CtA is more dispersed than CtS: the median value is €84.7 and values range from €43.1 to €126.8 (excluding extreme values). We found no correlation between a retailer's size and CtA. Most retailers having a low CtS also have a good performance with CtA.

Acquisition strategies remain diverse amongst retailers, from "aggressive" to "light" ones. On the one hand, some retailers manage to acquire more than 15% of their customer base each year after taking into account churn. On the other hand, most retailers acquire less than 5% of customers each year, some managing only inbound calls in a non-competitive market.

CtA indicates the efficiency in sales and provides input on customer lifetime value or how long a customer needs to stay with the same retailer to generate benefits.

Channels generate different costs

When analyzing CtA by channel, the Web channel is the least expensive means to acquire customers. Inbound calls constitute another efficient channel. For half of the participants, reselling partners and sales representatives constitute valuable acquisition channels. Outbound calls, retail outlets and retail partnerships, which mobilize significant upfront investments, are expensive acquisition channels considering that the success rate is generally low for these channels. Very few participants achieve low CtA through these channels.

Poor performance in CtA also arises from inefficient processes

When analyzing the CtA of each channel, some participants have a very high CtA by contract, reflecting that this channel is in development or without a critical number of new contracts to balance fixed costs. For instance, some participants which are heavy users of the Web have a high CtA: the performance of a channel must not be taken for granted as it also relies heavily on process optimization.

In this 2nd edition of our benchmark, the best performers in CtA have a very different channel mix: all channels except retail partnerships are used by the best performers. This proves that most channels can be operated at relatively low costs.

Some channels are more powerful to acquire a significant number of customers

One could think that it is easy to have the best channel mix: just combine effective Web and call center inbound. But these channels are not the most efficient for high acquisition rates.

In the benchmark's sample, the preferred channels of aggressive retailers are: sales representatives, call center outbound and call center inbound. Some also use retail partnerships or reselling partners.

As a whole, the most used channel for acquisition is call center inbound with 38%, the second most used channel is sales representatives with 17%, followed by retail outlets with 14%. However, it is worth noting that participants, as shown in Figure 8, have either a very traditional approach (call center inbound and retail outlet) or an aggressive one (sales reps).

There is not a unique optimal channel mix

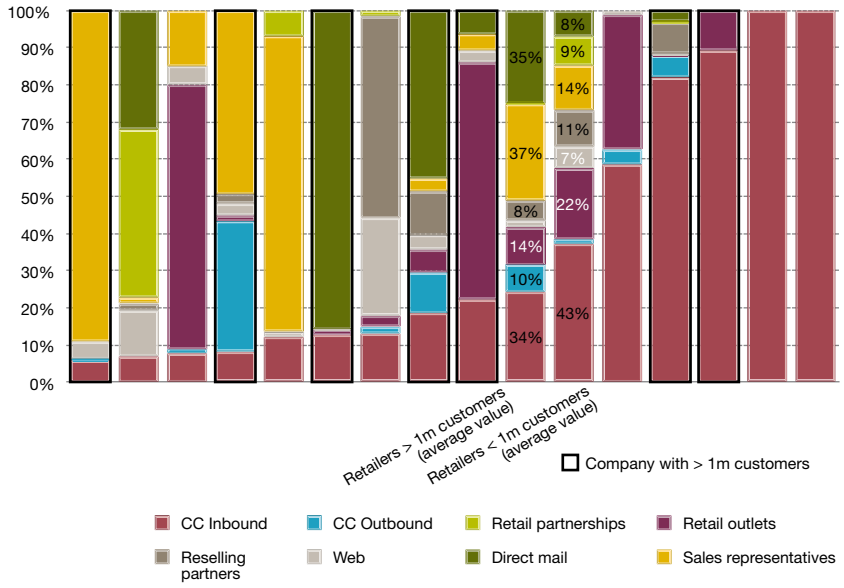
Channel choice is a matter of cost and sales efficiency:

- retail leaders in their market or with low competition can rely on cheap channels like the Web and inbound calls
- others have to include more powerful or selective channels in their mix in order to meet their sales objectives.

This highlights the questions to answer when setting up a multi-channel strategy:

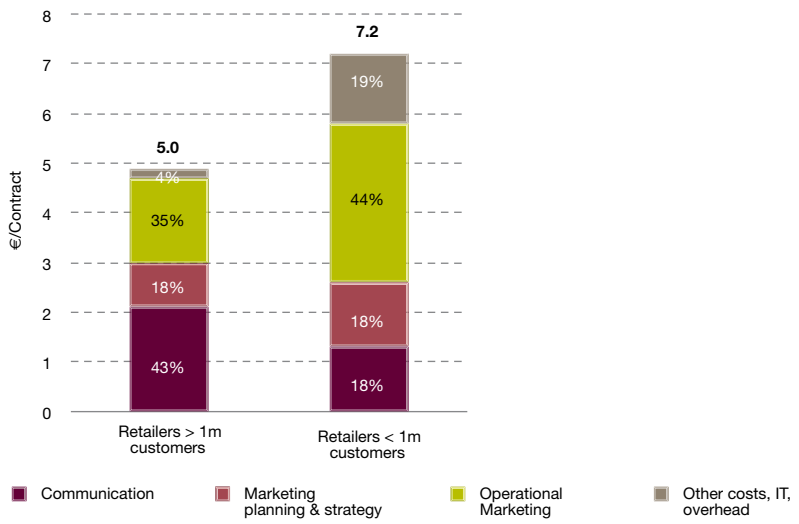
- is my channels mix aligned with my sales objectives?
- are my chosen channels' processes optimized?
- what are their current costs?
- do all channels generate enough sales to cover fix costs?
- are my channels independent or am I able to combine channels to finalize sales?

Figure 8: Contracts per channel



Source: Capgemini Consulting retail benchmark 2010

Figure 9: Marketing Costs – Process view per existing contract (corrected by PPP index)



Source: Capgemini Consulting retail benchmark 2010

Marketing Costs vary greatly between participants and seem to be size-sensitive

Marketing Costs per existing contract range from €1.7 to €12.9 (excluding extreme values) with a median value of €5.8.

Our analysis of marketing costs shows the existence of two different profiles based on a retailer's size (Figure 9):

- retailers with more than one million customers tend to focus their spending on communication and branding
- on the other hand smaller retailers seem to dedicate the largest part of their budget to operational marketing (new offerings roll out and existing offerings portfolio management). They also suffer from lack of economy of scale to absorb overheads and almost-fixed costs like marketing strategy.

Small retailers, and especially new entrants, have to bear in mind these differences when building their strategy. Some participants have also experienced that operational marketing, through setting up complex offers, can impact CtA and CtS.

Optimizing CtA and Marketing Costs is not only a matter of channel mix and process optimization

Customer Relationship Management processes are linked: marketing strengthens brand image and creates attractiveness; acquisition transforms the prospect's interest into sales; but then the service should be able to fulfill the promise. Marketing and acquisition are not stand alone processes: they are the first steps of the customer journey.

We believe that effective retailers optimize their activity as a whole. Cost control is mandatory but is not enough to build long term efficiency. One should also consider the whole customer journey and experience while optimizing processes.

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Acknowledgements

We would like to thank the 15 clients having participated in this second edition for their support and their insights throughout the project.

We would also like to thank the Capgemini regional community which played a key role in interacting simultaneously with participants in each of the European geographies.

Last but not least, the following Capgemini Energy, Utilities & Chemicals team members have been instrumental in the success of this program: Sopha Ang and Philippe Coquet from the Utilities Strategy Lab, Carolina Di Pietro from the Italian Utilities practice, Bettina Buchert and Marc Petry from the German Utilities practice, Bernard Malfliet from the Belgian practice.

Disclaimer

This study is based mainly on company data and on some public information. It is regarded as accurate as such as of June 2010. The information contained in this report is dated material.

The content is intended as source for information and discussion and should not be regarded as a complete analysis. Before disclosing final results, Capgemini Consulting team had an interim review with almost every participating company to ensure the sharing and the validation of the results.

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