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Smart electricity – threat and promise

Smart technology, combined with changing consumer demands, will have some hitherto unforeseen effects on retailers

If the relationship is based purely on price the customer will leave without any hesitation, but if it is based on trust and good service the customer relationship will be "sticky": the customer will keep coming back for more.

Energy companies are already hard at work on planning the practicalities of smart meter roll-out to meet the government's 2020 target, but there are less obvious, and potentially even more far-reaching, implications that they have yet to get to grips with. This paper focuses on two major changes to the market that we believe smart metering will entail.

Open third-party access to consumer data

Subject to opt-in, smart metering could bring open access to customer data. This will make it easy for third parties to approach customers with alternative offers tailored to their needs. It could also lead to an automated broker service that provides these offers automatically. Under new arrangements currently under discussion, customers may be able to switch instantly between suppliers. The result could be to intensify competition to an unprecedented level.

Communications access into the consumer's home

Energy companies are likely to gain the ability to beam messages to the home over the smart metering infrastructure. There could be 24x7 data access to the home. Energy companies will be able to offer their customers additional services – whether energy-related or not. However, the opportunity may draw new entrants, with greater experience of this type of communication, into the market.

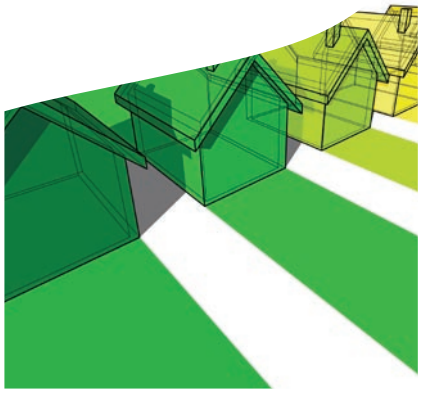
Companies need to position themselves to take advantage of the changes outlined above before others do, both to retain their existing customers and to attract new ones. Because the changes, in particular access to data, will tend to commoditise the market, companies will need to build new types of relationship with customers to avoid churn. If the relationship is based purely on price the customer will leave without any hesitation, but if it is based on trust and good service the customer relationship will be "sticky": the customer will keep coming back for more.

In this paper we review the two changes in more detail, before discussing how retailers should respond to the consequent threats and opportunities.

Open third-party access to consumer data

Within the bounds of the Data Protection Act, there is potential **for data to be made available to multiple service providers.** In fact, consumers may actively choose to have their data made available so that offers can be pushed to them.

Among other things, this will mean that competitors will be able to approach your customer with alternative offers based on knowledge of their usage patterns. These patterns will allow retailers to shape tariffs for groups of similar individuals. For example, customers who use their



Consumers' appetite for cheaper and greener offers is growing

These developments will make it much easier for both you and your competitors to approach your customers with new propositions, and they will come at a time when consumers are becoming increasingly receptive to such propositions, for both financial and environmental reasons.

Financially, the current recession and the forecast of increasing energy prices are making consumers more conscious of both costs and prices. On the environmental front, sustainability incentives from government, together with social pressures to be "greener", will accelerate growth in consumer awareness of renewables and energy efficiency. Offers of cheaper or more environmentally-friendly products and services are likely to be well-received, therefore.

washing machines a lot could be offered a time-of-use type tariff so that they can take advantage of off-peak rates.

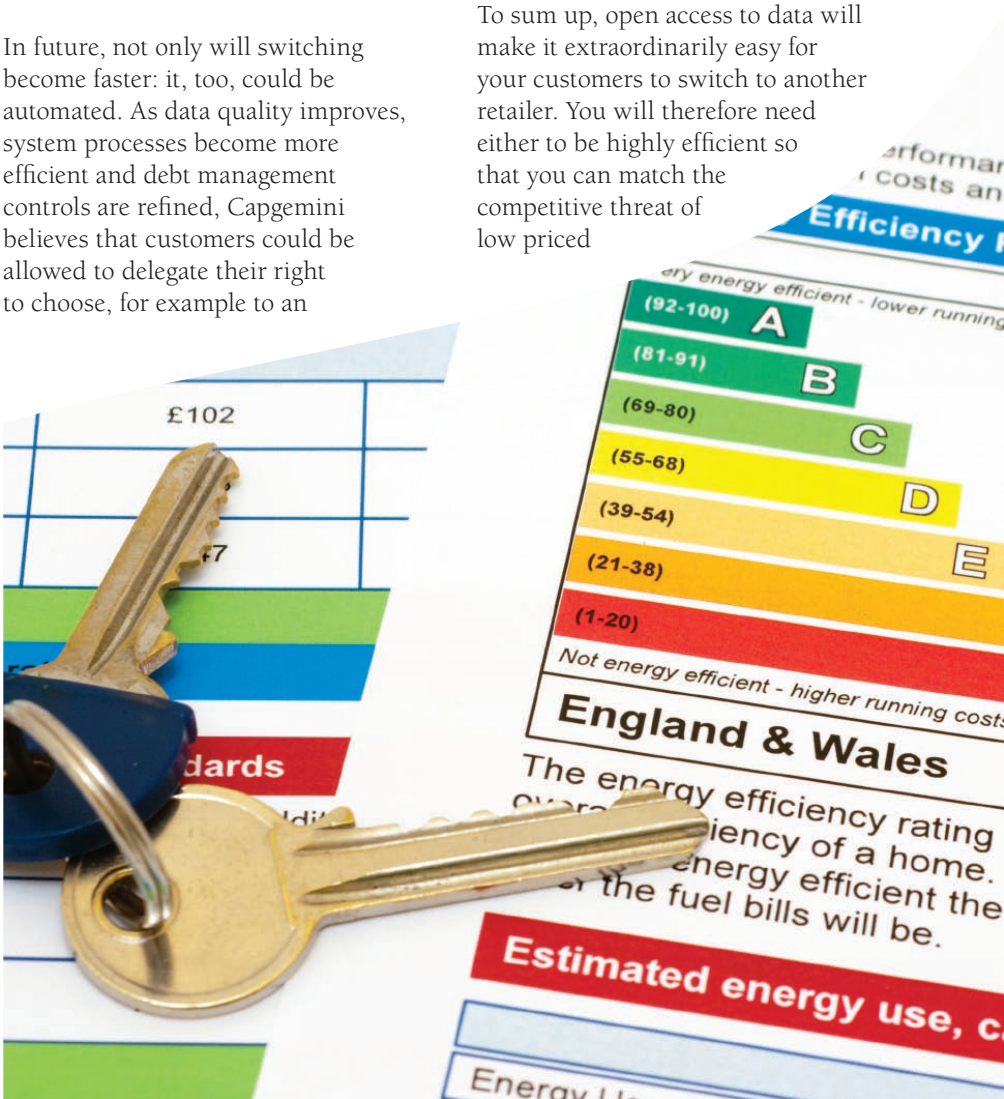
Rather than depending on individual retailers' systems, these approaches may well happen by means of Automated Tariff Selection (ATS) brokers. These centralised systems will automatically match consumers to the lowest-priced retailer based on the consumers' usage data and the tariffs and plans that the retailers have available.

These developments could have very serious implications for existing retailers, particularly as it will also become much easier for consumers to switch from one supplier to another. Currently, automated tariff selection is not practicable as the switching process is cumbersome and the change-of-supplier process takes weeks to complete.

In future, not only will switching become faster: it, too, could be automated. As data quality improves, system processes become more efficient and debt management controls are refined, Capgemini believes that customers could be allowed to delegate their right to choose, for example to an enhanced broker service. This development, coupled with open access to data and faster switching processes, could lead to some customers switching between tariffs and retailers more frequently – perhaps even daily.

Once this facility is available, a certain number of customers can be expected always to choose the retailer offering the lowest price. Unless they are confident of consistently offering the lowest price themselves, retailers will have to offer customers other inducements to stay. These could be based on energy demand management, shared investment in renewables or other services which create a durable long term relationship. Another option would be to try to lock in the consumer contract at a given price for a given duration. We will say more about these options later in this paper.

To sum up, open access to data will make it extraordinarily easy for your customers to switch to another retailer. You will therefore need either to be highly efficient so that you can match the competitive threat of low priced



offers, or else you will need to find other ways to make the relationship a lasting one. Probably you will attempt some combination of these approaches; again, a later section of this paper will discuss this idea further.

Communications access into the consumer's home

Although the exact technology has yet to be established, smart metering will mean fast two-way links into the consumer's home, so that the meter can be remotely read and its settings adjusted, for example in order to change tariffs. In addition, this communication could mean the establishment of a 24x7 portal into the consumer's home.

We expect that these links will also be made available for other purposes: for example, to push more services to the consumer. These could be energy-related services, such as automated Energy Management Services and automated or remote appliance management and maintenance. Both energy consumption and small-scale green generation can be managed remotely, helping consumers to meet their cost and CO2 objectives.

However, particularly if the links take the form of fast broadband connections, they could also be used to advertise a whole range of non-energy-specific services. In 10 years' time, energy companies could be offering their customers telecoms-based services that go well beyond energy management, such as streaming movies and social networking. They could even be sending special offers for local retail outlets or arranging insurance of household goods.

While this possibility would open up new revenue streams, it would also attract streams of new market entrants. Telcos, for example, will be only too well aware of the attractions of a market offering 24x7 access to the consumer plus information about consumer behaviour through the day. Competitors like this are already experienced in pushing advertising to consumers and could steal a march on energy companies if the latter are not prepared. At worst, these new competitors could start to "own" the customer relationship and even usurp the energy companies' traditional business by selling consumers power at attractive tariffs.

Summing up, if retailers rise to this challenge they could strengthen their relationships with consumers by providing valuable energy-related services and other services that the customer will welcome, while increasing their revenue. Strengthening the relationship in this way would reduce the risk of losing customers to competitors purely on the basis of price.

If retailers get it wrong, though, they could lose business to competitors, possibly from other sectors, or annoy and alienate their customer with unwelcome offers. Once again, this is an area that needs careful planning.

Four retail operating strategies

As we have seen, the two changes described above will present both opportunities and threats for retailers. Whether you win or lose will depend largely on your ability to plan and prepare.

We find it helpful to think in terms of four possible strategies, which we'll call low price, low cost, reducing churn and creating stickiness. We will discuss these in turn below, although in practice companies will need to use a combination of them.

Strategy 1: low price

Providers offering low prices will have strong appeal, initially for the financially aware, footloose consumer, but others are likely to follow. In the scenario described above, with open third-party access to data and

The challenge for the retailer is to link the service to the sale of energy, otherwise the customer may choose the lowest priced energy and purchase services separately.

automated brokers, it will be easy for these consumers to switch supplier on the basis of price, potentially from day to day.

Adopting a low price strategy will mean providing a basic, tariff-based service with the minimum standard of technical connectivity and service provision. Despite its broad appeal to consumers, this is the least profitable strategy for retailers, with room for only one or two low price players at a given time. The remaining competitors must retain a focus on price, but will also need to consider other strategies to prevent, or at least delay, their customers from switching, and the entire industry from moving towards the low price paradigm.

Strategy 2: low cost

This strategy focuses on total cost of energy usage rather than price alone, and offers consumers services that manage their energy use downwards. It will appeal to environmentally conscious customers who want to limit their CO2 footprint, and could be a way to retain these customers for the longer term.

The challenge for the retailer is to link the service to the sale of energy, otherwise the customer may choose the lowest priced energy and purchase services separately. Ensuring the services are of high quality is one way to induce the customer to come to you for energy as well – your company can come to be seen as the expert on energy conservation, rather than just a seller of electricity.

There is also the option of creating a long-term contract for both services and energy, perhaps bundled with funding for green generation assets or remote energy management appliances. Loans for energy-efficient equipment could be provided, with a low rate of interest that would be conditional on staying with the retailer throughout the life of the loan. (But even without that additional tie, experience shows that the more services a customer receives from a retailer, the stickier they are.)

Strategy 3: reducing churn

Although automated brokers make it possible for customers continually to switch between suppliers to keep costs down, in practice a substantial proportion of customers may decide not to do so. At present only about 15-20% of customers switch retailers each year, even though everyone could do so in theory.

Research shows that when people switch, they usually switch to the lowest price, but the stimulus that makes them go is not usually price. It is more likely to be something like poor service, an inaccurate bill, or some adverse news in the press. Some of these stimuli are within the control of the retailer.

After the advent of automated brokers it will, as we have seen, become much easier to make the switch, and many consumers are likely to do so sooner or later. The retailer's best hope is to delay the switch as long as possible by avoiding poor service and any other triggers.

Retailers therefore need to take action now to make sure they fully understand the avoidable causes of current customer churn, and minimise them. Further ahead, they must carefully manage the rollout of meters to their customers, to avoid adverse experiences that could trigger customer switching.

Strategy 4: creating stickiness

One way to counter the new competitive pressure is by offering goods and services that make the customer want to come back for more. We have already touched on the idea of sharing risks and rewards

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with the customer, for example by investing in green generation on behalf of the customer or managing their revenue streams. This idea has the ability to provide a multitude of service offerings but also to lock in the consumer for a long term relationship.

Energy services and applications could also create stickiness, as could offers of appropriate non-energy services such as entertainment, social networking or home security, although obviously companies need to think carefully, and evaluate risks, before entering completely new areas of business.

Combining the strategies

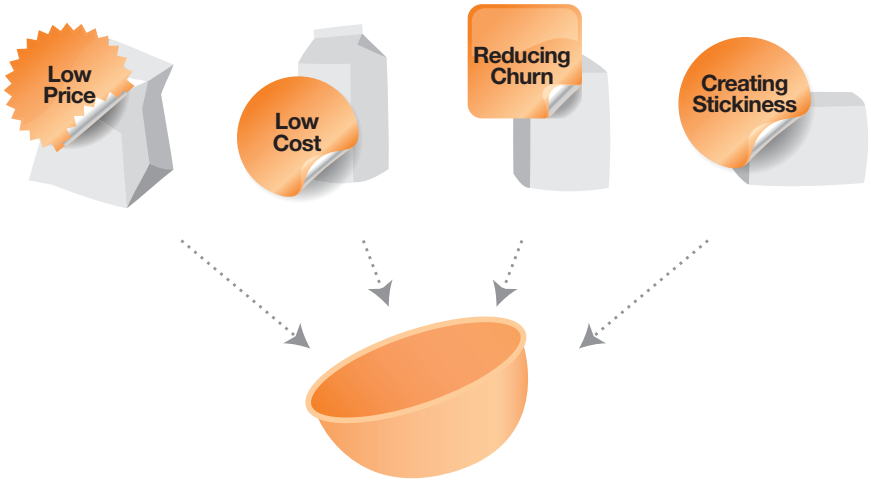
Although it is helpful to think in terms of the four strategies, in reality no retailer is going to espouse one strategy and ignore the rest. In fact, the retailer that combines all four most effectively is going to be the one that leads the market. The mix will probably change over time, too: it will often make sense to start by taking steps to reduce churn (strategy 3), which will buy you time to become more efficient so as to be able to reduce prices (strategy 1) and costs (strategy 2). Offering sticky propositions (strategy 4), particularly those that involve entering new markets, may come later.

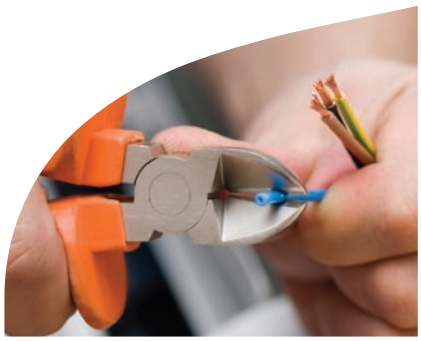
What companies need to do above all, though, is make sure they understand their customers – their financial constraints, their green aspirations, and so on. This understanding will tell them what combination of strategies will make the customer want to keep doing business with them rather than with a competitor.

Why work with Capgemini?

Capgemini is uniquely positioned to help with this challenge. Not only do we have one of the world's strongest smart energy teams, with an established international track record; but we also have extensive experience in building customer relationships in industries such as telecoms and financial services that have led this field. We can help you learn from these other sectors to get ahead of your competitors, both existing and new. In addition we understand the different types of telecommunications infrastructure that may underlie smart metering, and can help you unpick the various business implications of each.

Figure 1. Combining the four retail operating strategies





Conclusion: readiness is everything

We believe the changes described above will intensify competition between existing players and also open the market up to a potential flood of new competitors. That in turn will force retailers to make dramatic changes to the way they interact with their customers. It is vital to be prepared.

Preparedness means working creatively with the strategies above to hold on to customers. Reducing costs and improving service levels will be critical, but so will the adoption of new IT and the creation of value-adding services that will strengthen the customer relationship, such as those that reduce environmental impact.

Of course, increased competition is a two-way street. For retailers that make the right adjustments, the coming changes present huge opportunities to win new customers and revenue streams.

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