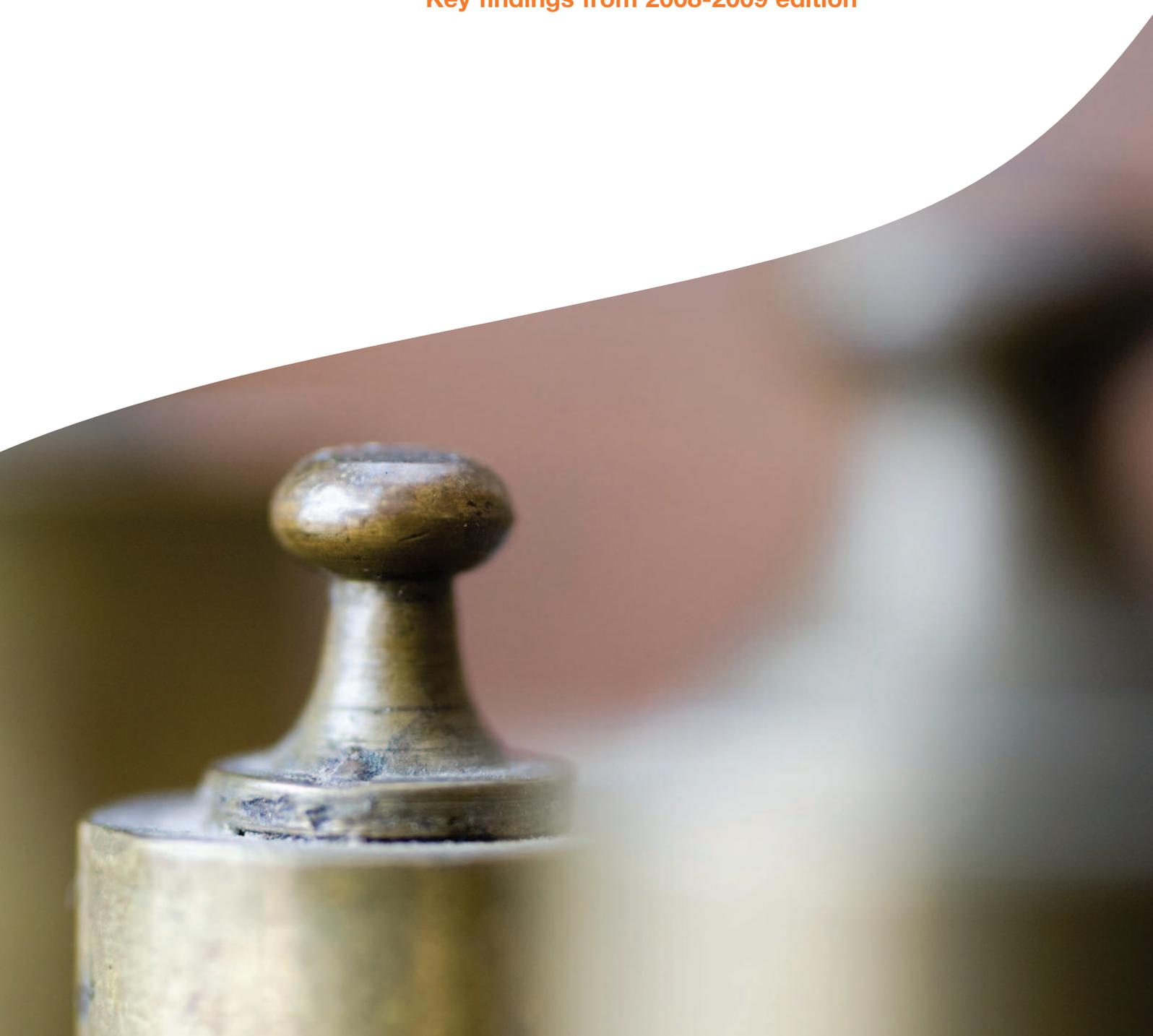


# European multi-client retail mass market benchmark

Key findings from 2008-2009 edition





**Introduction**

Cost to Serve (CtS) and Cost to Acquire (CtA) are considered as key drivers for retail utilities’ profitability, especially in the household market where a single customer can only guarantee a very low margin per year. Nowadays, with deregulation taking place in nearly every European country, the unbundling between distribution and sales activities as well as increasing competition have made cost reduction even more critical, both for electricity and gas retailers. **Today, in several European countries, net margins per customer are below 3%, representing just €10 to €25 over a full year of power delivery (whilst gross margins usually stand in the 10-15% range for electricity and 5-10% for natural gas).**

Therefore, we have chosen to launch this multi-client study to help retail companies to assess their current setup and to compare it with European peers, and to help them understand the differences and the viable strategies to lower their CtS and their CtA.

**Participating Companies**

For this first edition, we chose to target companies:

- Operating mainly in the mass market segment
- Managing mainly small, and medium to large client portfolio (i.e. from 100,000 to 6,000,000 customers; but excluding from our panel extra large customer bases)
- Offering either single or dual fuel.

**Figure 1: Retail organizations having participated in the 2008/2009 Cost to Serve Benchmark**



20 retail organizations agreed to participate in this first edition and benchmark their CtS. Among them, nine were able to participate in the CtA analysis. Our sample includes 35% of companies with a client base above 1 million, 50% of companies offering dual fuel, 30% of companies operating in high competitive markets, 25% of companies operating in non deregulated (or theoretically deregulated only) markets. Finally, our sample includes 15% of companies which can be qualified as “low cost” retailers, although all of them are actually a subsidiary of a Utility company.

In the following editions Capgemini will plan to have a larger panel and to include some very large operators.

### Benchmark Methodology

Our study was initiated in October 2008 and was completed in May 2009. It relates to company data in 2008. The Capgemini CtS and CtA benchmark model is based on 250+ data points collected by means of an Excel questionnaire filled by each participating company.

In order to produce as comparable data as possible, we didn't just enquire of the participants' Profit & Loss data. Instead, we used a mixed top-down / bottom-up approach. Profit & Loss data has been collected as a starting point for economic data. Then, a full set of operational data has been collected (for example the number of FTEs per process, the number of contacts for each different activity and so on) in order to split costs into individual entities. Finally, individual data has been regrouped into a typical retailing structure, both in a per-process view (10 processes including service, billing, credit collection, payments, etc.) and in a cost-element view (12 elements including FTEs, outsourcing, print &

mail, telecom and so on). All the final data has been verified with the participants in order to assess the inconsistencies in the input data and to verify the adherence of our model results with the structure of each specific retailer.

The 250+ collected data points have been used not only to process economical figures but also to compare operational performances, especially regarding the main CtS and CtA drivers (number of calls per customer, payment methods used, etc.). In this way we were also able to provide the participants with insight on best practices and how to improve their cost performances.

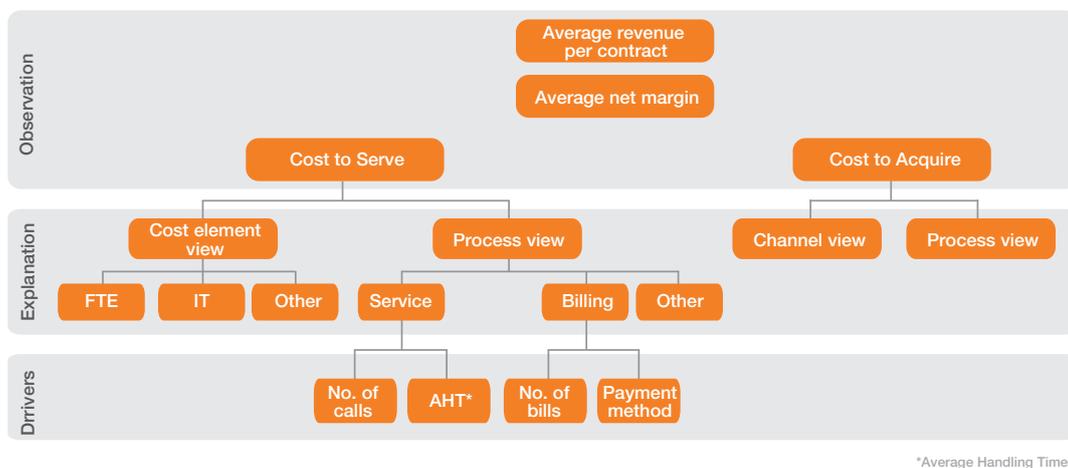
For the CtA, the analysis was performed on three axes, including the per-process and the cost elements view (as for the CtS) but also the channel-view. In this way, we were able to evaluate both the performances on each channel and the effectiveness of the channel mix used by each retailer.

Finally, in order to make results comparable across EU member states, all CtS and CtA values were equalized using the PPP<sup>1</sup> index, assuming that the majority of cost elements are ruled by local market prices. Among the participating countries in our benchmark, the most impacted countries have been the Czech Republic and Slovakia, for which CtS and CtA have been corrected (downgraded) by approximately 35%, together with Norway, Denmark and Switzerland, which had their CtS and CtA corrected (upgraded) by 25 to 35%. For other participating countries such as Germany, Italy, Netherlands, Belgium, the PPP equalization – index close to 1 – did not impact the results significantly.

### Overview of Retail Competition Across Europe

Retail competition across Europe is heterogeneous making any country to country efficiency comparison of this market difficult and hence requiring great care in the benchmarking process.

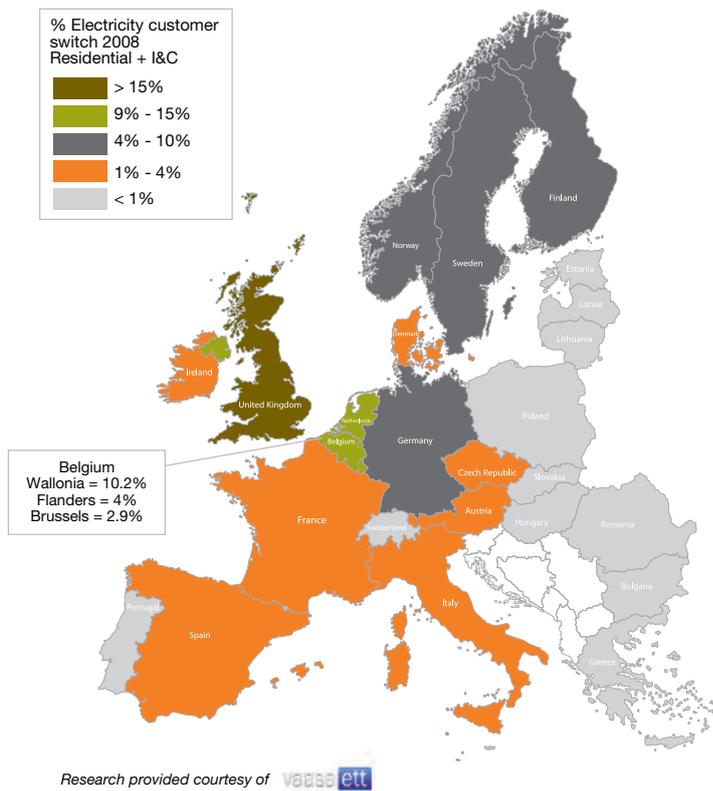
Figure 2: Methodology – Drivers, Explanation and Observation



\*Average Handling Time

1 PPPs are currency conversion rates that convert economic indicators expressed in national currencies to a common currency, called Purchasing Power Standard (PPS), which equalizes the purchasing power of different national currencies and thus allows meaningful comparison. PPPs are generated by Eurostat and are accessible from the OECD internet portal ([http://www.oecd.org/departement/0,3355,en\\_2649\\_34357\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/departement/0,3355,en_2649_34357_1_1_1_1_1,00.html))

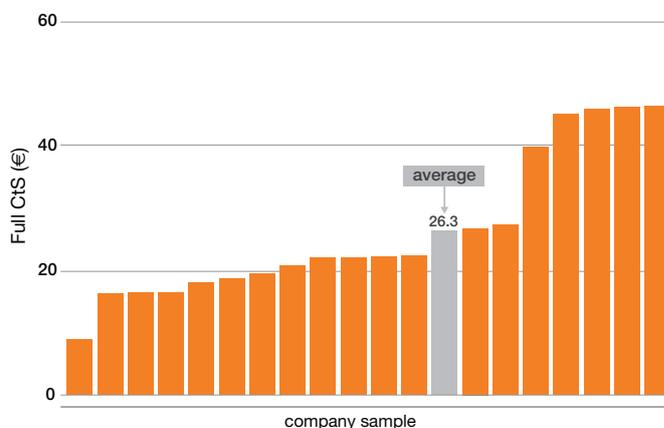
**Figure 3: Switch Rates across Europe (2008)**



Several reasons can explain such diversity:

- Market opening timelines have been different across Europe. The very first European country to create a competitive retail energy market was Norway in 1995, i.e. 14 years ago. On the other hand, France and Italy chose to open their residential energy market only in July 2007, i.e. two years ago. Swiss and Portuguese (gas) residential markets are today still regulated ones. Such heterogeneous history – stemming from local legislation – has triggered diverse customer behaviors, materialized by diverse switch rates across EU member states.
- The size of the retail businesses is very heterogeneous across Europe. EDF, with its 26.5 million customers in France, can not really compare with Hafslund, the largest Norwegian vertically integrated utility with its portfolio of 620,000 electricity clients.
- Buying habits are also very different across Europe too. In the Netherlands, households have been used to dual fuel offers from their Utility companies for many years and such a model is a natural one today, with major players having quite a balanced portfolio of electricity and gas clients. In the UK, dual fuel dates back from the early days of residential competition. In countries such as Italy and France, Utilities dual fuel strategies are more recent and portfolios of dual fuel clients are still thin. In other countries, such as the Czech Republic or Austria, dual fuel offers simply do not exist.

**Figure 4: Full Cost to Serve per contract (corrected with ppp index)**



**Cost to Serve: The Key Metric for Benchmarking Efficiency of Customer Service Operations within a Retail Business**

In our sample, full CtS is quite dispersed, ranging in general from €16 to €46 per contract, with the average standing at €26.

## Customer Switching Still Increasing – But a two tier split emerges



Switching activity in Europe saw significant transition in 2009, with convergence occurring as the most active markets largely sustained and some less active markets increased their activity. The overall picture however, is an increasingly two-tier Europe, split between those with active competition and those with competition present only in the medium to large I&C market. Of the 26 European markets followed by the VaasaETT Utility Customer Switching Research project, seven significantly increased their switching rates. The European average switching level for 2008 was consequently only slightly changed at 3.5%.

### Hot and Active Markets

Great Britain remains Europe's most active market in terms of customer switching, maintaining its nearly 20% level of switching in 2008, but Wallonia\*, The Netherlands and Germany were the rising stars of 2008 rising to over 10%, 9% and nearly 8 percent respectively. Switching was fueled for instance by high or rising prices and some aggressive new entrant marketing. These markets became Europe's second, third and sixth most active markets respectively. Finland also increased to over 5% following substantial negative publicity resulting from price rises and other corporate issues, and France finally became active despite a relative absence of price incentives.

Upon further analysis, there is a significant underlying propensity to switch among the more active European markets. When appropriate switching conditions prevail, switching levels tend to increase suddenly and dramatically, falling back somewhat when conditions are less appropriate, but never becoming inactive. This propensity to switch is increasing over time, gaining momentum from each successive period of volatility.

### Fallers

Swedish and Norwegian switching levels fell slightly but remained the fourth and fifth most active markets in Europe respectively, indicating a temporary cyclical easing but no more. Other fallers included Flanders (Belgium), Denmark, Ireland and Iceland, but these too were only small changes and not an indication of any trend change.

### Dormant Markets

Despite the overall increase in activity, 10 of the 26 markets surveyed have switching levels below 1% and in several cases have less than 0.1% switching. These markets have no apparent switching propensity, largely because competitive conditions remain inappropriate due to for instance excessive market concentration, a lack of new entrants, poor customer awareness and low price caps. Most of these markets are expected to remain inactive for some time to come.

### Recession – a major impact

There is no doubt that the economic downturn has provided fresh impetus to switching activity in Europe, however the predominant impact has emerged only in 2009 when switching levels in some countries have rocketed. During the first half of 2009 alone, the European switching rate average has increased to around 5%. During the same period, Ireland has experienced an annualized rate of nearly 20%, Denmark, Sweden and The Netherlands rate of around 11-12%, Finland 7%, and even France has seen its highest ever rate of over 3%. Market analysis has revealed that the recession has generally increased customer sensitivity to price levels.

*\*The Switching level in 2007 was higher than 2008 but was only based on months of complete data*



Best in class are either incumbents operating in dormant markets, or small companies operating in very competitive markets. Incumbents operating in dormant markets still benefit from low demand from their customer base and are not required to improve or transform their business operations.

Companies operating in very competitive markets have already gone through huge transformation and IT programs, and they have already put in place cost optimization programs: organization, processes and IT systems are already optimized. Low performance companies are mainly large incumbents in markets where real competition has started to emerge. The state of the market leads to necessary transformation programs, when their size and the incumbent's position makes such programs difficult and costly to put in place.

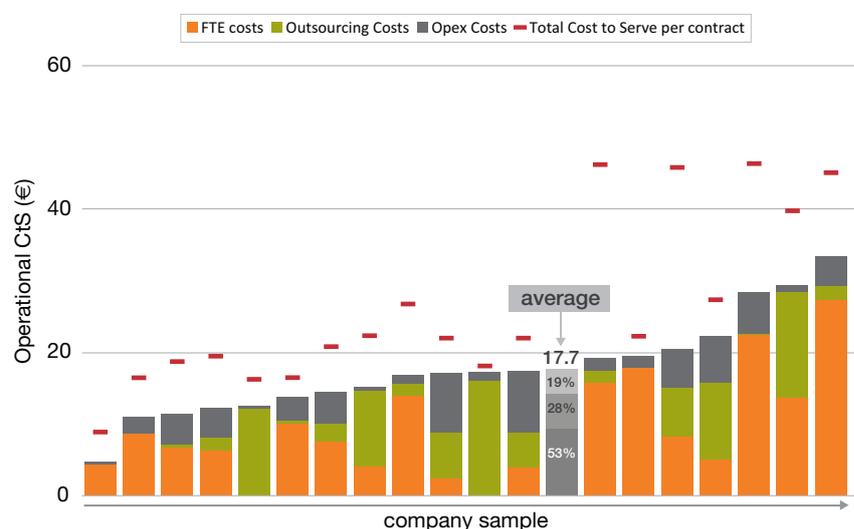
When breaking down CtS by major cost elements, we can observe that:

- Overheads and other costs can severely impact the full CtS of some of the companies. This is

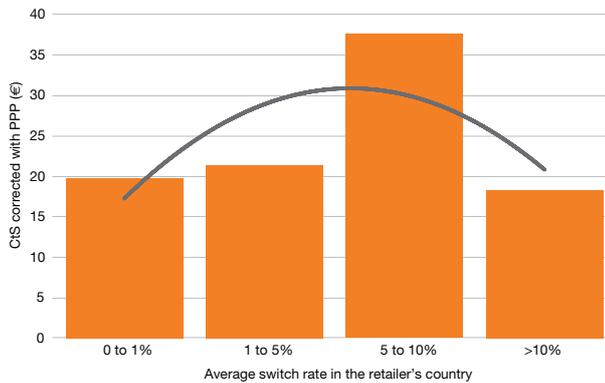
mainly true for medium to large size incumbents, which have to pay for corporate staff, or organizations having to support (by law) heavy bad debt.

- IT costs may also have an impact on the full CtS, especially when including amortization of existing systems maintenance and renewal. Again this is mainly true for medium to large size incumbents.
- When breaking down CtS by major business process, unsurprisingly, **service (front office) and billing account for the largest proportion of the total (50% of the total in average with 32% for service and 18% for billing)**; payment & collection accounting for only 11% of the total in average.
- Hence in order to remove the influence of overheads and bad debt on our CtS rankings and thus get a more homogeneous view across participants, we chose to calculate **an operational CtS, which excludes overheads, other costs such as bad debt, and IT.**

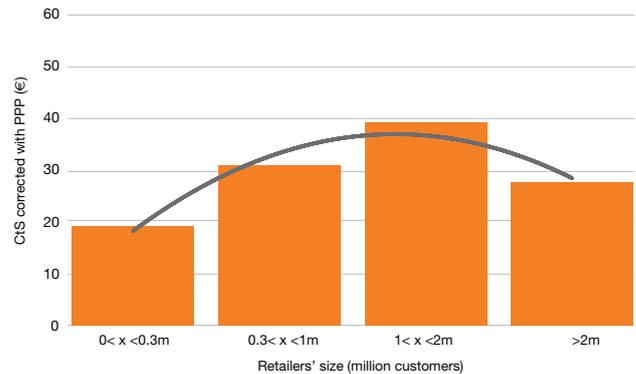
Figure 5: Operational Cost to Serve (corrected with ppp index)



**Figure 6: Competition level is impacting Cost to Serve**



**Figure 7: Retailer's size is impacting Cost to Serve**



- Operational CtS ranges in general from €11 to €33, with the average standing at €18

### Correlation Factors

With robust CtS metrics computed for all participating companies, the next step in our research was to validate through regression techniques the main factors impacting CtS. Our analysis tends to highlight two main factors:

- A “**competition factor**”: CtS increases significantly when customer switching suddenly gains momentum, and decreases significantly when markets become more mature and retailers’ efficiency increases through operational excellence programs.
- A “**scale effect**”: CtS increases significantly when the customer base of a retail organization reaches the 1 million+ threshold and then slightly decreases when the Retailer has 2 million+ clients.

### Main Optimization Levers

Across our sample, **people costs represent almost 60% of total CtS on average**. Naturally, optimizing service center’s agents’ time should

thus be the first work stream to be launched.

In this area, Capgemini’s experience is that best levers of optimization come from:

- Lowering the contact ratio; in our sample it ranges in general from 0.6 to 2 with average at 1.3.
- Lowering the call handling time; in our sample it ranges from 3 minutes 20 seconds to almost 10 minutes with an average of 6 minutes 13 seconds.

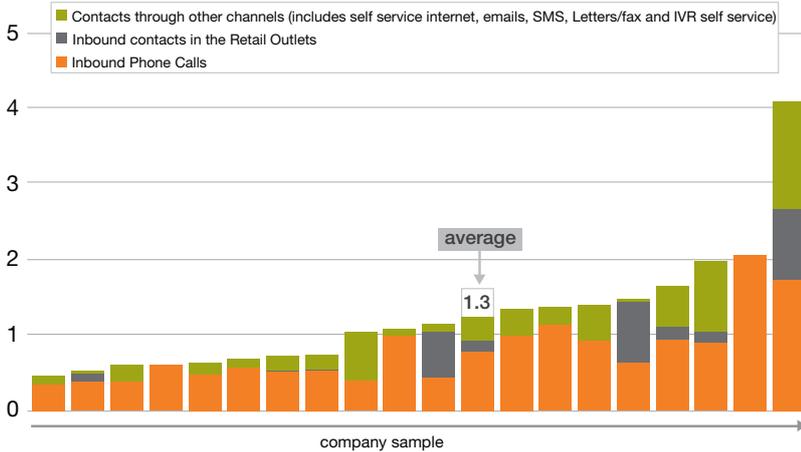
Analyzing the breakdown of contacts per channel shows that in the Utility industry, telephone remains the prominent channel for household customers to interact with their supplier. It is also worth highlighting that low cost retail organizations in our sample are the companies exhibiting the lowest proportion of inbound calls in their contact mix.

Analyzing the call handling time is critical when analyzing the performance of a service center organization. Interestingly, some of the participants were not able to provide a clear data-point for this indicator, and very few participants

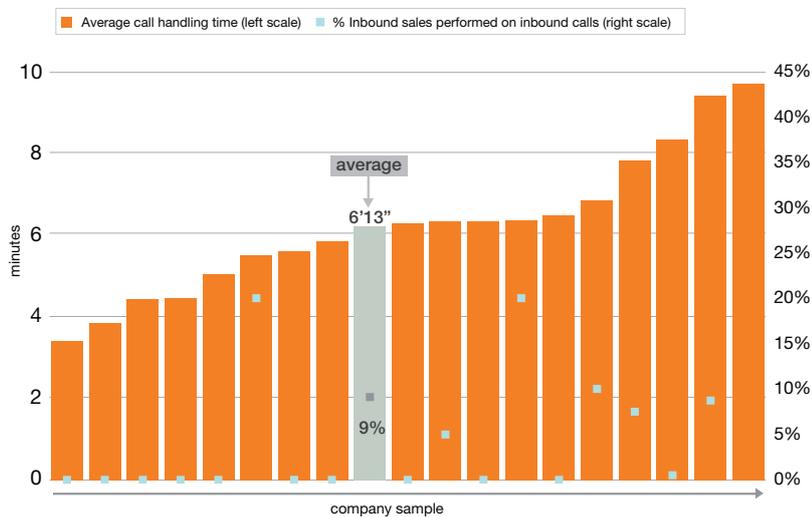
were able to provide a split of call time structure (i.e. identification, resolution, wrap-up). Unsurprisingly, with a few exceptions, as shown by the orange dots in figure 9, cross- or up-selling actions impact call handling time. All companies (but one) below 6 minutes are not performing any sales on their inbound calls. Most companies (but two) above 8 minutes are performing sales activities on some of their inbound calls. As the CtA analysis of our benchmark reveals, inbound sales is a cost effective channel. It seems, therefore, that companies need to strike a balance between striving for low call handling time and sales effectiveness in today’s increasingly competitive markets.

Analyzing the calls’ typology is also critical too in order to assess the performance of a retailer service center organization. For doing so, capturing the main processes calls are related to, as well as differentiating between first-time calls and repeat calls is essential. Monitoring the main processes calls are related to enables the organization to spot a weak process and fix fairly quickly (e.g. if a lot of clients call to request checking a

**Figure 8: Number of contacts per contract per year**



**Figure 9: Time required to process a customer's call (in minutes)**



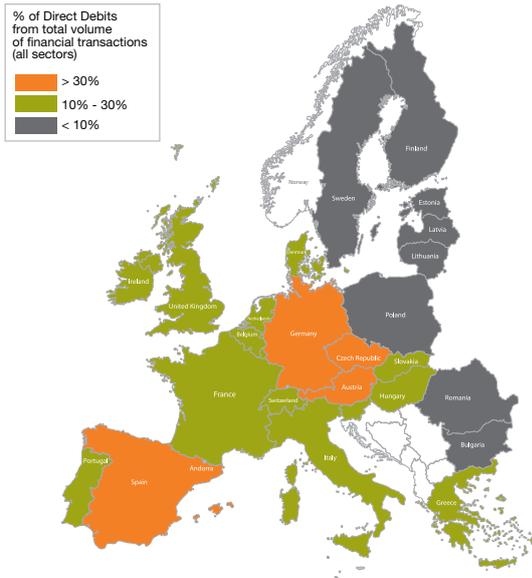
bill, the retailer may need to check its billing process which is generating the calls to see if there are some errors during the billing runs). Monitoring the percentage of repeat calls enables the organization to spot any decrease in its customer service level, (e.g. increase in repeat calls may mean that front office teams are not properly trained to handle specific client requests, or to solve specific client issues). Surprisingly, very few organizations within our sample were able to provide clear data for this indicator.

Overall, outsourcing seems to be fairly well leveraged, with almost two thirds of our sample's participants having outsourced at least some functions of their service center. In some cases, above average salary costs coupled with fully in-sourced services might suggest further analysis of outsourcing pros and cons.

Overall, the Utilities are leveraging their trust to their clients by using way above average Direct Debit payment instruments to lower their transaction costs. Direct Debit is used for 50% of all payment transactions in our panel whereas the average proportion of Direct Debit transactions in all financial transactions is only 25% on average in the same participant countries. However, Internet self-service that could generate potentially lower transaction costs seem not to be leveraged enough compared to what we observe in other services (e.g. public services), and telephone – accounting for 75% of all contacts in our sample – remains by far the most common interaction channel between utilities and their clients. Self-care strategies are still underdeveloped in the Utility industry, generating a large potential for efficiency improvement.

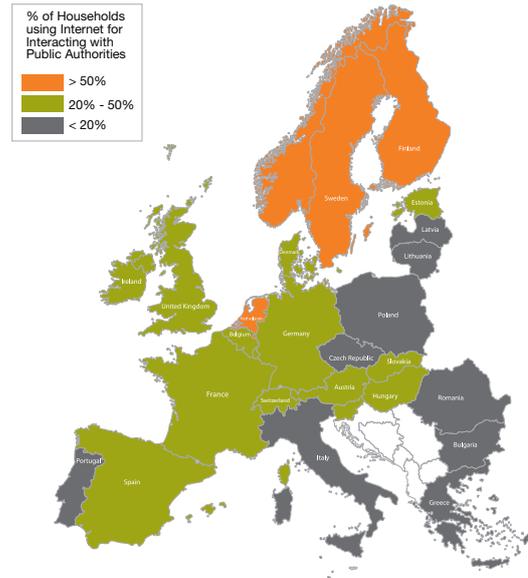
**Figure 10: Penetration of Direct Debit and Internet usage across Europe (minutes)**

Penetration of Direct Debit usage across Europe (2007)



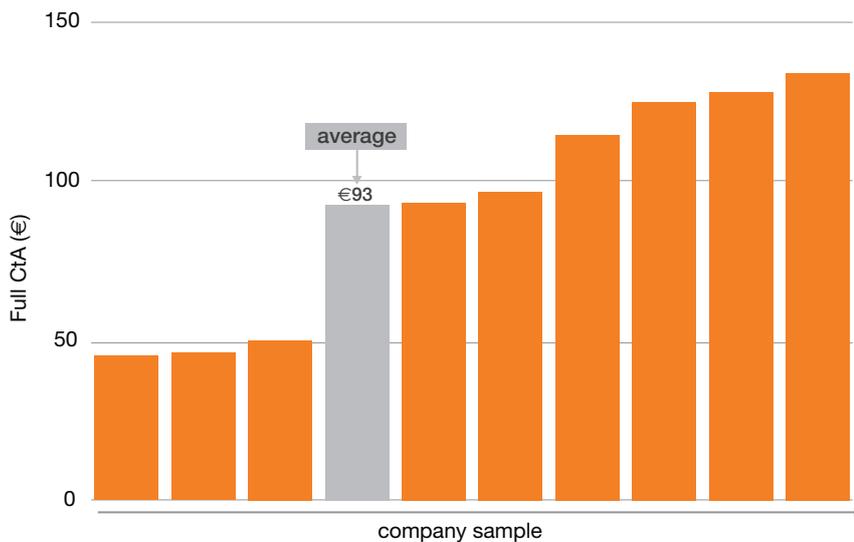
Source: European Central Bank Payment statistics 2007 data

Penetration of Internet usage across Europe (2008)



Source: Eurostat Internet Usage by Households in 2008

**Figure 11: Full Cost to Acquire (corrected with ppp index)**

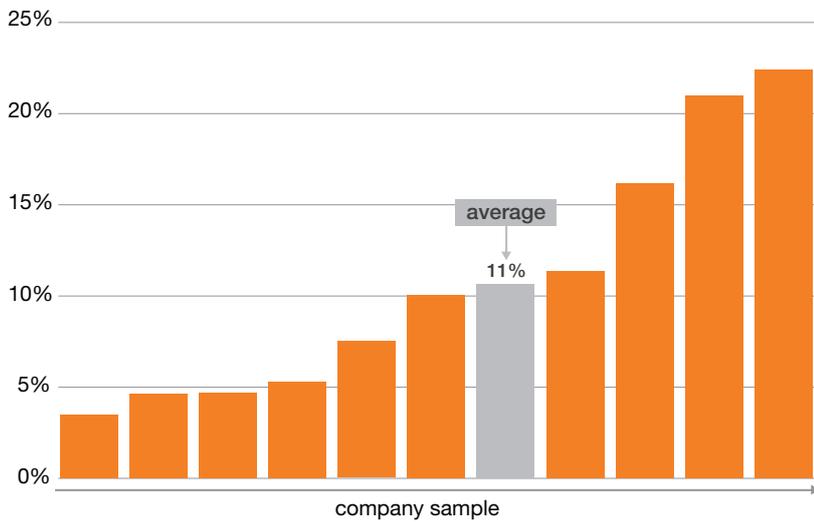


**Cost to Acquire: Key Metric for Benchmarking Efficiency of Sales and Marketing Operations within a Retail Business**

Only around half of our sample (nine retailers) was eligible for our CtA analysis. Two reasons explain this: On the one hand, some companies operating in non deregulated environments do not have acquisition strategies. On the other hand, some participants were not able to provide all the data points required for generating a detailed and relevant analysis of this complex indicator. From our sample, full CtA is quite dispersed, ranging from €45 to €134 per contract, with the average standing at around €92.

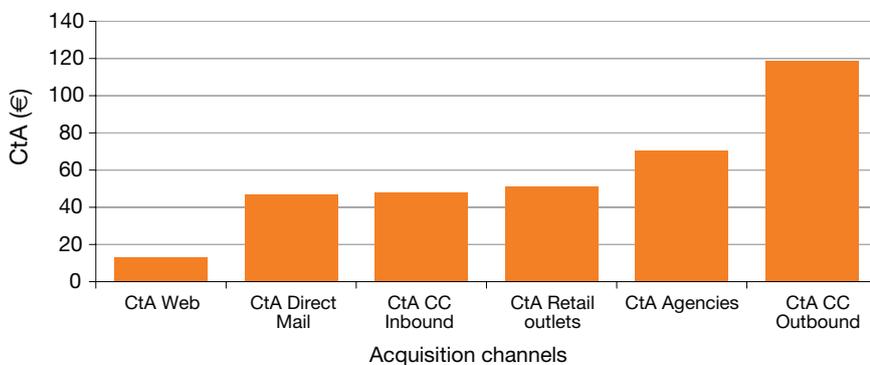
In today's increasingly competitive markets where customer churn is gaining momentum, reducing acquisition costs and increasing client retention become more and more

**Figure 12: Annual Customer Acquisition as a percentage of total portfolio**



Analyzing more precisely the channel mix, the efficiency of each channel and the investment needed can allow optimizing operations and thus lower the CtA. Unsurprisingly, the Web channel is the least expensive way to acquire customers. For all the companies using this channel, the ‘CtA Web’ is way below the average total CtA. The best performers are the ones who have an efficient Web acquisition strategy coupled with performing inbound sales. Agency (partnerships, door to door etc) and outbound calls are expensive channels. When they don’t enable companies to gain a critical number of new contracts, these channels impact the average total CtA severely.

**Figure 13: Acquisition cost per channel**



Call center outbound sales as well as cross- or up-selling through the inbound calls’ channel are among the most developed channels in our sample. Shifting the acquisition channel mix towards more ‘dematerialized’ channels such as the Internet can dramatically lower acquisition cost.

**What’s Next?**

With the positive voice of our 20 participants who accepted to join this first benchmark, we are confident that our second edition will be even more successful, gathering participants from a greater number of EU countries, with an even broader spectrum of participant’s profiles.

The launch of the second edition is scheduled during the first quarter of 2010, with results (based on 2009 data) expected during the third quarter of the year. However, pre-registration will open on October 1, 2009, so get ready to join our 2009-2010 program!

important. Our research shows that on average, it would take nine years to recover acquisition costs, taking into account an average net margin of 3% or €10 per year.

The best performers in terms of acquisition volumes are retailers operating in highly competitive markets. They are able to acquire between 15% and 20% of their total client base over one year. Another finding worth highlighting is that, with a few exceptions, the best performers in terms of CtA are also the best performers in terms of CtS.

The main component of CtA usually relates to the sales contact costs. This is the process which drives the overall performance.

The best performers are retailers who have managed to keep these costs low compared to their number of acquired clients.

Acquisition strategies are very different across our sample. Some retailers have no acquisition objectives at all (even for retailers operating in competitive markets), others have very aggressive strategies.



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The Utilities Strategy Lab (USL) is a global network of sector specific consultants and research specialists dedicated to generating content-rich insights into the utilities industry.

Lab Products include:

- Points of View on emerging industry trends and topics,
- Monitoring the development of the energy market: The USL leads major thought leadership programs including the European Energy Markets Observatory research program which monitors annually the progress and challenges of the European Electricity and Gas markets since 2002. All research within this program is conducted independently of clients. Collaboration with related industry experts is however common and partners include Energy Think-tanks (VaasaETT), Media Groups (Platts), Financial Analysts (Société Générale), Law firms (CMS Bureau Francis Lefebvre).
- Client bespoke research and analysis: The USL delivers strategic research, benchmarking and business model evaluation expertise directly to clients or as a subcontractor to existing Capgemini client engagements throughout all geographies.

### Acknowledgements

We would like to thank the 20 clients having participated in this first edition for their support and their insights throughout the project.

We would like also to thank the Capgemini regional community which played a key role in interacting with participants in each of the 10 European geographies simultaneously.

Last but not least, the following Capgemini Energy & Utilities team members have been instrumental in the success of this program: Sopha Ang from the Utilities Strategy Lab, Andrea Petrini from the Italian Utilities practice, Berend Olde Rikkert, from the Dutch Utilities practice, and Philippe David from the Global Utilities practice.

### Disclaimer

This study is based on public information and regarded as accurate as such as of May 2009. The information contained in this report is dated material. The content is intended as source for information and discussion and should not be regarded at a complete analysis. Before disclosing final results, the Capgemini team had an interim review with almost every participating company to ensure the sharing and the validation of the results.

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#### European Energy Retail Switch rates - courtesy



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