Seven Potential Supply Business Strategies

Recent transactions and JVs in the UK utility sector provide mounting evidence that companies in this once homogeneous sector are starting to adopt very different strategies and business models for their supply businesses. While no one approach has yet emerged as the best and only solution, seven distinct business models have already emerged.

Introduction

There are many potential strategies that energy supply companies might adopt. These can be categorised into three groups, depending upon whether the company considers its skills to be in trading, retailing, or the provision of supporting services. These can be further subdivided by the products/services offered and the market sectors targeted.

'Energy trading' strategies

Some existing energy retailers may consider that they have the skills, expertise, and assets to grow their energy trading business. This may be because they have access to generation or other assets that others do not, or because the particular characteristics of their portfolio means that they are better positioned to manage risk in the market place.

Strategy 1: Vertical Integration to support retailing

In the UK, vertical integration (e.g PowerGen/East Midlands, npower/Midlands, TXU) was one of the earliest responses to fierce competition in supply, but recent suggestions that TXU and PowerGen would be willing to sell their generation assets suggest that this approach might be less relevant as the market matures and the contract market becomes more liquid.

Strategy 2: Trading without retailing

If energy trading really does create value, then it could, in principle, exist without a retail business. The trading company has two main services it can offer: trading services; and wholesale supply.

Trading Services: the company could sell its services to small, niche players without an in-house trading function. Examples of stand-alone energy trading groups trading and managing risk on behalf of third party retailers include Power New Zealand and TXU Europe.

Wholesale Supply: given regulatory clearance, trading companies could sell energy to a small number of aggregated customer groups ('clients'), such as local authorities, retail park managers, housing estate developers, community groups, etc. These 'clients' then bill the final customers for energy supply with other services provided, such as management fees, rent, rates, membership fees etc. The trading companies would provide support/advice to clients as required, but the final energy users have a contractual relationship with 'client' not retailer.

'Retailing' strategies

We consider it likely that energy retailers will have to move away from a 'one size fits all' mentality, to focus on particular market sectors – domestic and small business customers have very different requirements from large industrial users and multi-site customers. The business model is therefore different, and while a single company may attempt to cover all sectors of the market, it is likely that multiple brands and service offerings will evolve.

Strategy 3: Home Services

Many supply companies believe that the essence of energy supply is ‘buy, repackage, bundle and sell’. This approach requires a strong focus on and competence in traditional marketing areas (purchasing, product development, channel management, branding, etc.) which presents a huge challenge, notably for the incumbents. Also, most people consider that a strong national brand is a prerequisite for the domestic mass market, and yet there are few strong brands at present. To date (and it’s only our opinion), the strongest brands nationally would seem to be British Gas, PowerGen, and Virgin (only recently). Potential new entrants include Direct Line, Tesco, and Visa.

Examples of companies focusing in this area include British Gas and Virgin (only available outside the London Electricity and SWEB franchise areas). British Gas already had a dominant position in contract maintenance of gas appliances, and insurance against equipment failure – the acquisition of the AA added greatly to the service offering, which now includes financial services (loans, insurance etc.) as well as roadside assistance and travel advice.

Strategy 4: Business Partner

Several suppliers have chosen to serve only industrial and commercial customers – examples include Enron Direct, Gas Light & Coke, and Electricity Direct. Other suppliers, recognising that the large energy users have different requirements from other users, have set up dedicated teams within their organisations to focus upon these customers.

While the price clearly has to be competitive, some companies are starting to offer more than just supplied energy. London Electricity, for example, offers business recovery services, enabling customers to get back in business quickly in the case of any local disaster (fire, flood etc.). Other companies offer varying degrees of facilities management and on-site energy management services. In the future, we consider that

- tariffs and prices will reflect value to customer, not cost of supply: may include guarantees and insurance against loss of supply
- suppliers will offer to take on responsibility (commercial and environmental) for delivered energy (steam, heat, compressed air, refrigeration, motive power etc.) production/supply to the customer premises
- this may include facilities management on larger sites, including generation plant, switch gear and transformers, and customer networks

For example, BHP recently sold all its on-site generation in Australia to Duke Energy, who will manage all BHP’s on-site energy requirements, and build, own, and operate any new plant on BHP sites.

Strategy 5: Sustainable Energy

A number of companies have already appeared, offering green electricity to both domestic and non-domestic customers – UK examples include Ecotricity and Unit[e]. In general, these companies

- procure energy from sustainable energy sources (either on market or from own plant), and sell to customers willing to pay premium
- may offer environmental services to business clients, taking over responsibility for dirty incinerators etc. and replacing with cleaner plant

In the future, we consider that they may also trade environmental credits as that market develops.

'Other services' strategies

We consider that some of the existing energy retailers may choose to exit retailing to concentrate on providing supporting services to other retailers. These services might include call centre management, billing, debt collection and customer database management. But they would be competing directly with non-utility companies in many of these areas, and they are likely to find the market difficult. Potential products and services that could evolve include:

Strategy 6: Customer services

A number of former utilities (or parts of them) already provide services for third parties – examples include Enron (risk management), Accuread and Siemens (metering services), Global Customer Solutions in Australia and TXU (call centres and customer services), BillPay (in Australia) and Sutton & East Surrey Water (billing). In the future we consider that these services might include:

- call centre management
- billing (raising bills, production and posting, dealing with queries)
- debt collection and factoring
- direct marketing and market research (proactively calling selected customers on behalf of third parties)
- identification and proof of residence, credit scoring
- home moving services (dealing with utility and other service providers on the customer's behalf – may even include credit cards, mail services etc.)

In many cases, close identification with an active retailing business discourages other energy suppliers from subscribing to these services. In many cases, these service functions have found it beneficial to split from the parent company and to become separate companies in their own right.

Strategy 7: Channel management

Internet Portals are a hot topic right now – every week we hear about another start up, often involving a utility as one of the anchor suppliers and equity holder. But while it is clear that suppliers should aim to sell through as many channels as possible, many of these channels/market places are very similar – they lack a differentiating factor to set them apart from their competitors.

Accreditation: in the home services market, a number of energy suppliers (e.g. Eastern Energy, British Gas (via CORGI) and now Virgin Energy) have recognised the difficulty that customers have in identifying competent, reliable tradesmen. Channel managers with a strong reputation can assist customers identify good tradesman through some form of accreditation.

Third party services: channel managers with an active customer base can sell access to that channel to third parties. Where additional services are provided (such as call handling, sending brochures etc.), additional fees can be charged.

Conclusion

Any systematic approach to developing a supply business strategy should start from an examination of the market and an assessment of the various activities that make up the total supply process. Once these activities are identified, suppliers can assess which (if any!) they should focus upon.

In this article we have listed seven strategies that we have observed in the UK and other energy markets. While not mutually exclusive, we consider it unlikely that any company should attempt more than two, or possibly three at most. Maintaining focus on a limited number of strategic directions helps customers, staff, and investors to understand more clearly the company intent and aspirations.