

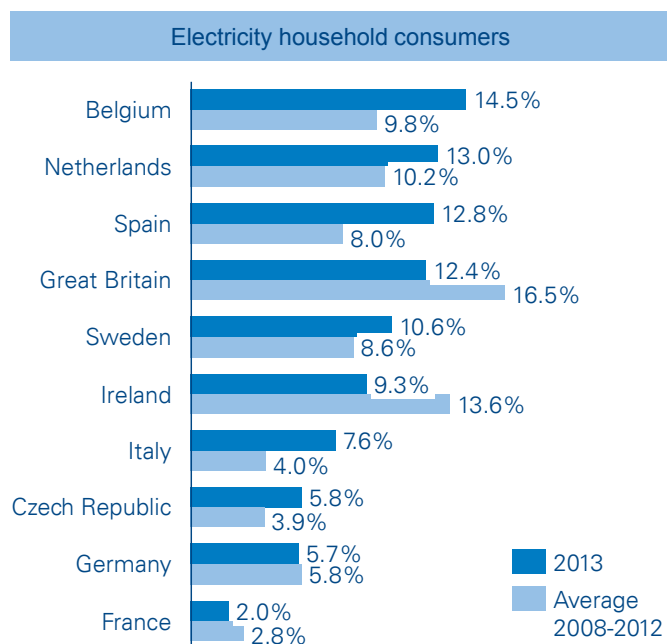
Churn management in utilities



Managing customer churn in power and gas utilities is a top priority in most European markets. Utilities are faced with ever-increasing challenges due to shifting customer preferences, the appearance of new offerings and of new competitors with different business models. The situation calls for a new, fresh look at how well customers are being served.

There is no doubt today that liberalization of power and gas markets in Europe has increased competition. This is shown in the evolution of customer churn, which as one of the key measures of competition, see Exh. 1 and 2.

Exhibit 1: Churn rates in Europe, % of customers switching electricity supplier

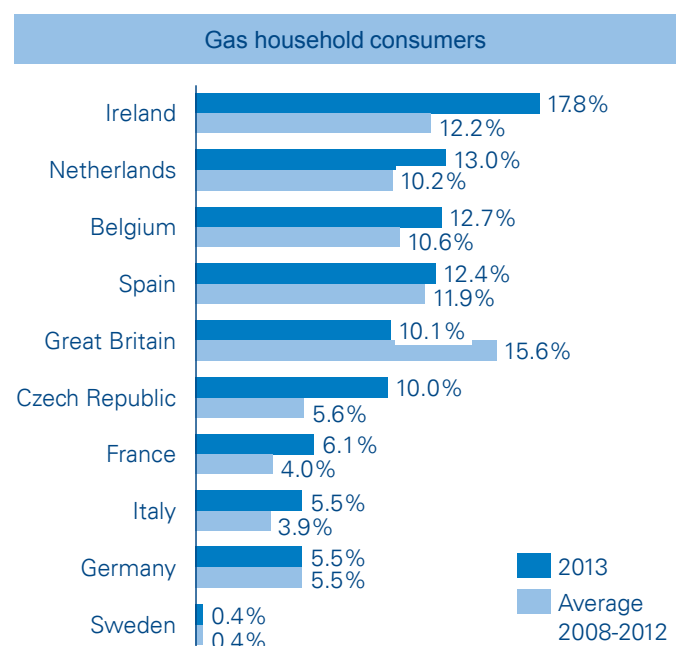


Source: CEER National Indicators Database

In addition to sheer customer preferences, the evolution of customer churn is also influenced by other parameters such as the evolution of wholesale prices (when there are major shifts in commodity costs, the more prone to switch customers will be) and the entry of new value propositions driven by new services,

better customer engagement or new suppliers being more attentive to customers' needs. In some markets other "push factors" are poor quality customer interactions, inaccurate bills and unresolved complaints that equally promote switching by pushing customers away. Customer switching can occasionally moderate itself for some time. But there is no doubt that it is here to stay.

Exhibit 2: Churn rates in Europe, % of customers switching gas supplier



Source: CEER National Indicators Database

The implication for power and gas retailers is that they must

manage customer churn as a first strategic priority with the appropriate loyalty and retention programs.

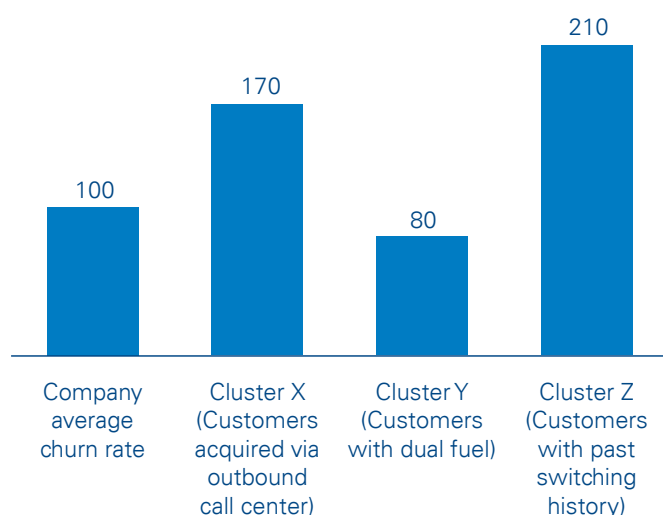
These programs build on three basic elements (1) an understanding of customer needs, preferences and their attractiveness, (2) a tailored offer and value proposition to such needs, and (3) good, quality service as standard. However, in today's world of digital natives, with ever increasing expectations of service, and information that is easy to access and compare, plus more and more players entering the power and gas retail arena, these basic elements are currently being sophisticated and transformed across many dimensions.

1. Understanding customer needs and their attractiveness

As markets have liberalized, the retail customers have progressively engaged in the competitive dynamic. Some of them were curious to shop for different offers. Others have been pulled by companies' sales efforts or discounts.

There are many sub-segments among the customer base receptive to and actively seeking new offers to meet their preference. Some of them are looking for the best rates, others for "certified green energy" or maintenance services offerings. Some want a fully-digital service, others prefer to speak to a sales rep. On the other hand, not all segments are equally valuable to supply companies – in fact some of them are particularly unattractive.

Exhibit 3: Examples of key drivers of churn in European utilities – sanitized examples, churn rate, indexed



Understanding and defining the most relevant drivers and preferences of such customer segments and how these affect their propensity to switch supplier is a solid first step. Many utilities have already gone through the path of identifying the drivers of why customers switch suppliers, leveraging internal information and customer surveys and have clustered them so

as to define new commercial strategies. Exhibit 3 illustrates some of the key drivers for churn management found in such analyses in leading utilities.

Other utilities have invested heavily in building databases and models to establish a value to each customer group, according to certain parameters that drive it such as customer preferences for products or services, their willingness to buy more services, to switch or to use certain channels, or likelihood to have payment problems, among others.

However, today's technologies are adding several layers of new complexity as well as opportunity. Availability of customer information grows exponentially when digital channels are used and when big data analytics' tools and real time iteration come into play. The ability to identify new patterns of customer preferences, to consider information from non-structured sources and to update segmentations in real time, allows the energy retailer to identify and to act on customer segments that a few years ago would go unnoticed.

The implication for power and gas retailers is that the segmentations used are changing dramatically as well as the sets of actions to approach them. The number of micro-campaigns multiplies itself, the nature, content and speed of communications are completely transformed and, thus, the ability to predict key elements such as their willingness to buy a product or service or the probability of defection to another supplier.

2. Tailoring the offer to customer needs

As in any business, the value offered to customers must be competitive. The degree or perception of competitiveness of an offering can vary across different segments, but no churn management program will solve a global uncompetitive positioning in, say, price or in service.

The key to tailor the offering is to establish a link between the identified clusters of customer needs and an adequate offering to such needs. In addition to the basic catalogue of products, pricing schemes and other options, today's offering must also include dimensions that are not easy to replicate and can provide an endurable value proposition to increase the loyalty of the valuable customers:

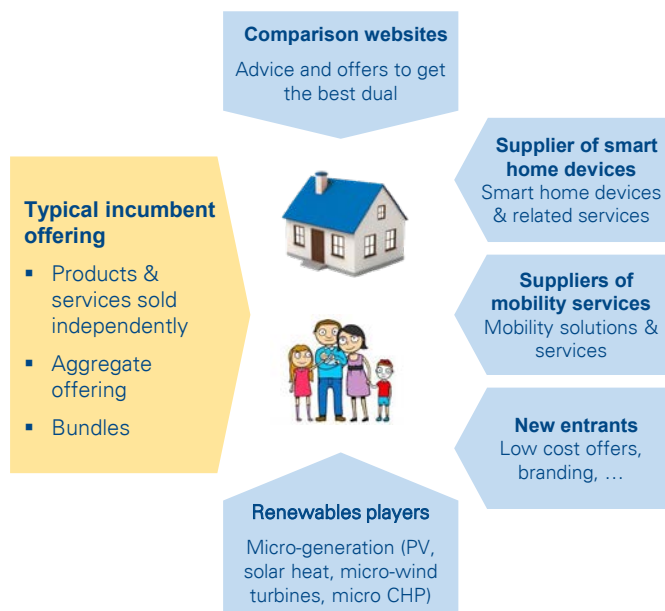
- Customer experience.** Most power and gas retail consumers today simply do not have a continuous experience with their utility –and, possibly, many might not want to- so there is a great deal to be developed in this arena (our benchmarks show that the average number of interactions per year is between 1.2 and 1.5, which in fact implies that 40-50% of the customers have no contact with the company whatsoever). Customer experience includes many elements, from the usability of their channels and processes for the most mundane information gathering and

transactions to the digital contents and related services that are becoming more and more relevant to create an attractive and meaningful experience for customers.

- **Personalization.** The ability to tailor the relationship with the company to the customer preferences. The appearance of new, adaptable and personalized services and devices opens up new opportunities in areas such as the energy management of the home (for instance, switching on/off the heating according to patterns of leaving/getting back home) and even e-mobility services. Other personalization options might involve the bills and payments management (self-management financing options for the peak months of winter) or the channels used to contact them. These services and options often create offerings that are difficult to replicate.
- **Engagement.** All the above require a mind-set shift towards how utilities interact with customers. In order to engage them, communication with customers must be bilateral, ubiquitous and with immediate response – quite the contrary to the views, not so far back in time, that utilities wanted to avoid customer interactions, because they have a cost. Today engaging with customers is one of the keys to retaining them.

Not all customers might want to engage with their suppliers -many of them will prefer to stick to the current status quo of products and service. That should be fine and it probably is a good option for a sizeable share of an incumbent customer base. Others, however, are being tempted by the offers coming from different sorts of competitors, each of them coming from a different angle – new entrants, local cooperatives, comparison websites, suppliers of smart home devices, suppliers of electrical mobility services,... - see Exhibit 4 that illustrates the competing choices for a typical household.

Exhibit 4: Evolution of customer loyalty



Incumbent utilities are facing competition from all these fronts. They need to pick their battleground(s): the customer groups that are more valuable to them and the tailored offerings they want to market. Competing promotions' timing-to-market has been substantially reduced too. As a consequence, particularly for the most dynamic customers, utilities need to build capabilities to shape the customer experience, personalize the offering and engage with customers at a rapid pace so as effectively to increase the loyalty of and retain such customer groups.

3. Providing a good service

The more the customers are engaged, the more they'll expect from their supplier. Quality of service is, has been and will be an ever-evolving concept. As the offering and the models to serve it get more sophisticated, it also requires adequate measures of quality of service that go beyond the classical ones. In this industry companies need to meet their regulatory requirements, of course, but that is clearly not enough. In the past, it could have been that answering a customer claim in, say, a couple weeks' time was "good enough". Today that is clearly not the case – regulation might not have changed, but customer expectations have, particularly in the most valuable and dynamic segments.

In addition, as the offering to customers is more and more based on digital content, services and communication that pursue customer engagement, key metrics of quality need to evolve. The user experience of company websites, apps and the rest of the channels is as significant to a good perception of service as the product delivery, if not more. Many utilities still use the "rank from 1 to 5" or "would you recommend" type of scoring on samples of customers that fall into different segments or use different services. However, as sub-segments and the offering of services multiply and channels move away from face-to-face and call centers to digital ones, these measures will need to be complemented by other, more tailored approaches in order to make quality management actionable.

How to go about it

As usual in these types of situations, the point of departure must be assessed both from a market as well as from an internal capabilities perspective. Different situations call for different degrees of aggressiveness in building new models and solutions to transform the existing capabilities.

Exhibit 5 illustrates the key building blocks to analyze to improve customer loyalty and retention, as well as the capabilities needed to be effective. Starting from the company's ambition and priorities, the three elements discussed in this article – customer needs and attractiveness, tailored offering and a good quality service- need to be thoroughly reviewed. These elements are typically supported by a number of enablers. On one hand

are the capabilities and tools to understand and manage these models such as analytics and propensity models that allow the retailer better to understand and foresee the different customer clusters preferences, dynamic segmentations and the ability to manage micro-campaigns that fit the customer clusters' needs. On the other, the organizational enablers such as the clarity of responsibilities and an end-to-end perspective of the teams involved, as well as the objectives and KPIs used to measure performance. A thorough and honest assessment of where a company stands and where it should be is the base required on which to build a new model or adapt the existing one.

Exhibit 5: Customer loyalty analysis framework



As with any similar transformation, as important as defining the end picture is how to define the path to implement in a way that starts achieving results from the beginning. This implies a pragmatic view on the tools, methodologies and capabilities to be put in place so that tangible targets can be achieved along the way. At the same time it must recognize that many of the internal capabilities are created and learnt "by doing."

Although each situation might be different, it is not uncommon to achieve a 2-3 percent reduction in churn in the first 12-15 months to further improve it in the 2-3 years thereafter.

With churn rates close to 12-15% per year in many markets, not adequately and actively managing customer retention is simply not an option anymore.

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