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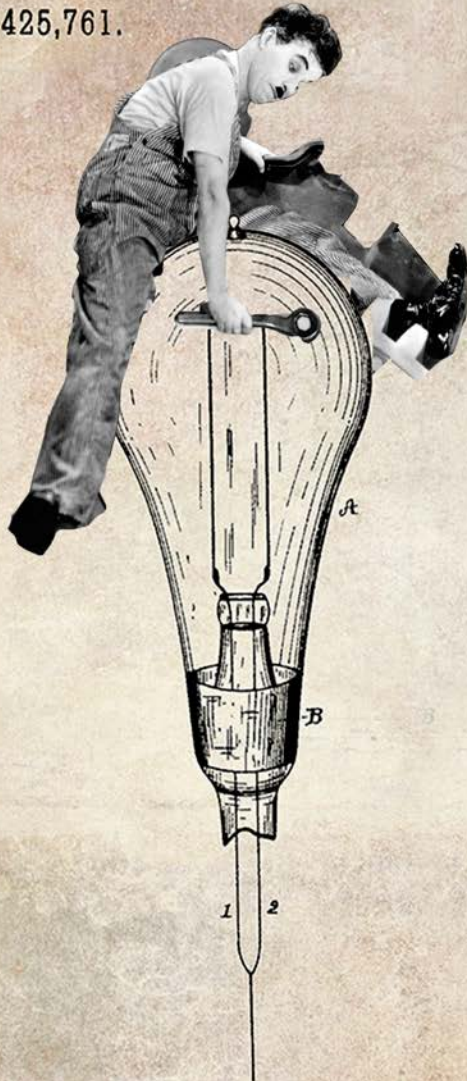


Illustration by Pilar García-Ferrer Rodríguez de Paterna

“E-lectric” customers

Understanding customers’ online engagement with their power and gas utilities: The case of Spain

October, 2017

Arthur D Little

Content

Executive Summary	3
Introduction: Welcome to Spain	4
1. Engagement = satisfaction = value	6
2. A wake-up call for incumbents	9
3. Prepare for action	12
Insight for the executive	15
Annex: Methodology & analysis	16

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Executive summary

“Utilities, brace for the online impact.”

The shift to online channels has long since ceased to be a current topic among companies in retail and banking, for example. These companies have redefined the customer relationship model, not only in their industries, but in other sectors as well. The utilities industry, which has traditionally not been engagement intensive, is being affected by this model redefinition and progressively moving to digital channels. The rise of purely online players, increasingly blurred market boundaries as utilities offer additional services, and new customer experience requirements have made this online move both challenging and critical.

In this viewpoint, Arthur D. Little analyzes Spanish online utility customers to understand how they engage with their utilities, highlighting the existing relationship between engagement, satisfaction and value and focusing on the growing relevance of online engagement. Furthermore, it points out the important gap that exists between challengers' and incumbents' online channels and engagement, reinforcing the call for urgent action.

Engagement, satisfaction and customer value are deeply intertwined. Assuring engagement and satisfaction is especially relevant in a market as dynamic as Spain's, with over 14 percent of customers having switched suppliers over the past year. Online switching still represents only a fraction of those who switched, but several indicators point towards its growth in the near future. The relevance of the online channel for searching and comparing and the potential limitations to doorstep selling are just two examples of these drivers, as experience in other markets has shown.

In this growing online reality, new online challengers are being quicker and more effective in catering to evolving customer tastes, while incumbents' online channels are still lagging behind. Not only do incumbents' customers engage less often with their suppliers, but when they do, it is mostly to generate non-value-adding interactions. On the other hand, challengers generate more value-adding interactions across both their physical and online channels.

Incumbents are faced with an urgent call for action. They must adapt their online channel offerings to ensure customer satisfaction and retention, and to position themselves for the new wave of online switching. This adaptation will involve a complete overhaul of their existing marketing and sales budgets and reconsideration of their commercial strategies, in order to differentiate the service offering and the company positioning, and to defend the margins in an ever-more-competitive marketplace.

The utilities industry has reached a tipping point. Now is the moment to decide which way to go.

Introduction: Welcome to Spain

Arthur D. Little’s survey and analysis illustrates Spanish customers’ online engagement with their utilities and the implications of this relationship.

An evolving market perspective requires incumbents to rethink and adapt to new realities

New offers and services, evolving consumer attitudes and competition are some of the main trends and changes affecting the utility-customer relationship in most European markets.

Currently, most of these changes come from online channels and digitalization, which have major impact on aspects such as engagement and switching behavior, and are setting the “new norm” in terms of service and availability.

While the Spanish power and gas market is still largely a “physical channels” market – i.e., door-to-door and branches are still the most relevant in acquiring new customers – online players have already established significant presence. However, given the magnitude of the implications of online relationships

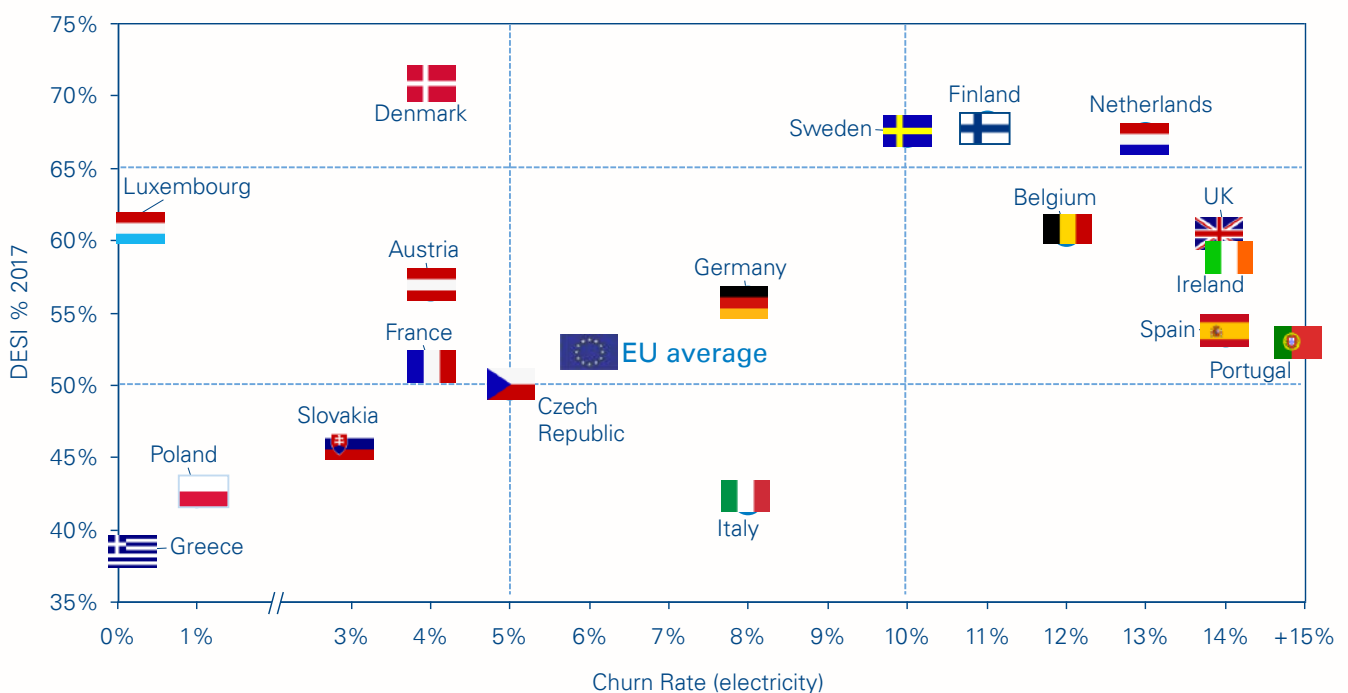
with customers and the speed of online adoption that is observed, utilities should seriously consider the dynamics in the online segment.

Three elements point to a rapid and substantial change in the coming years:

1. Spain is “digital ready” and “digitally engaged”

The Spanish market’s digitalization level is in line with the EU’s average and above that of other countries such as Italy and France, according to the European Union’s Digital Economy and Society Index (DESI). DESI evaluates each country’s digitalization in five main dimensions: connectivity, human capital, use of internet, integration of digital technology and digital public services. Although in line with the EU’s average,

Figure 1: Digitalization (DESI Index 2017) & churn rates



Source: DESI (Digital Economy and Society Index), ACER

Spain's level of digitalization still lies below that of the UK, Germany and Belgium, among others.

2. Spanish customers are among the most dynamic

In addition, as measured by churn rates, the Spanish retail electricity market is one of the most dynamic in Europe, with 14 percent of power customers changing suppliers each year.

3. Online adoption can gain momentum and speed up... fast

Some examples can illustrate the astonishing speed of adoption of online channels. In the UK, according to Ofgem,

online customer switching changed from 21 to 48 percent in three years. In Spain, the retail-banking sector has massively restructured its physical branches, reducing the number by more than 22 percent since 2012, as consumers have progressively shifted their interactions online.

In such an evolving context, Arthur D. Little has researched (see details in the annex) the online retail electricity customer segment in Spain to understand its basic drivers of value, the relative positioning of the existing players, and how to prepare for such a change.

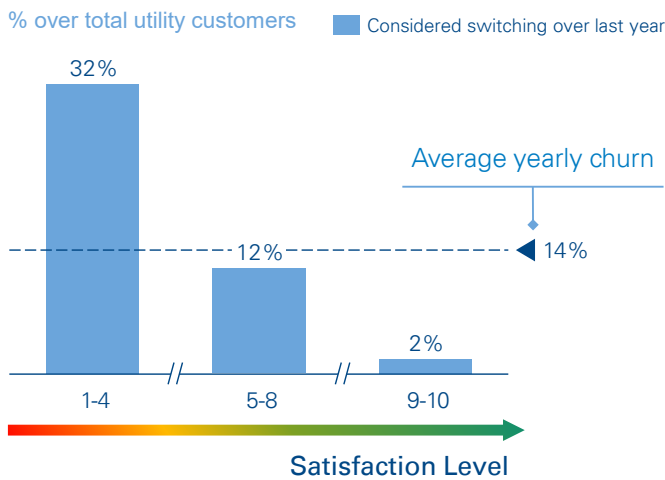
1. Engagement = satisfaction = value

In the online segment, there is a clear relationship between higher customer-utility engagement, satisfaction level and customer value. Incumbents have considerable room for improvement.

The more customers engage with their utilities, the higher the satisfaction levels and the lower the switching risk

The need to build strong relationships with customers becomes evident when analyzing how engagement relates to customer satisfaction.

Figure 2: Customers who have considered switching



Source: Arthur D. Little survey and analysis

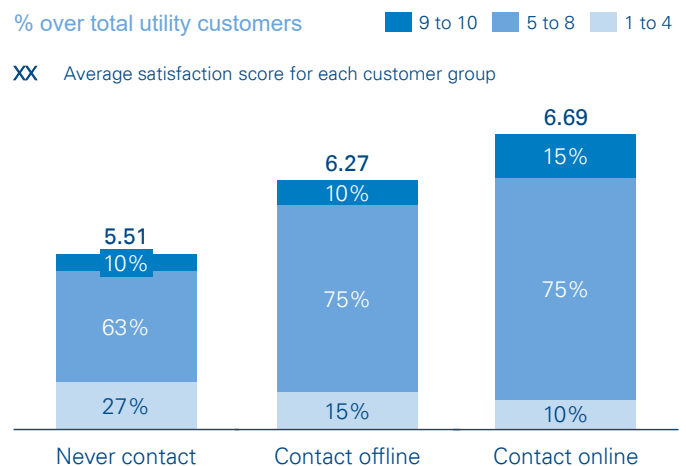
Customer satisfaction is an indicator of aspects such as consumer repurchasing intentions and loyalty. A satisfied customer base reduces churn, increases customer lifetime value and reduces negative word of mouth.

Our surveys and research indicate that while 32 percent of customers who are unsatisfied with their utilities (scoring 1 to 4 out of 10) state they have considered switching companies over the last year, this percentage falls to 12 percent among those who are neither extremely satisfied nor dissatisfied (scores of 5 to 8). Finally, only 2 percent of customers who have scored their satisfaction levels with their utilities as “excellent” (9 to 10) have thought about switching companies.

According to internal Arthur D. Little benchmarks, the marginal channel used to win back lost customers costs utilities today ~€150 per acquisition. For a utility with an average customer satisfaction score of 5–8, around 12 percent of its customers are considering switching. This means that for every million customers, this 12 percent of switchers will cost the utility more than €18 million to win them back into their customer bases. It is important for utilities to realize and monetize the actual impact of a satisfied customer base, and to understand the existing relationship between satisfaction and switching.

Additionally, those customers who state they never contact their utilities have significantly lower satisfaction levels than those who do. The gap also exists between those who contact the utility through offline rather than online channels. These differences can be seen in Figure 3 below.

Figure 3: Engagement and satisfaction levels



Source: Arthur D. Little survey and analysis

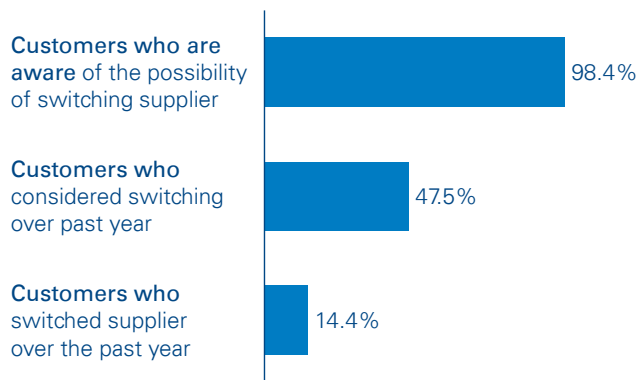
For those customers who decide to switch companies due to various reasons, online is gaining traction as one of the channels of choice

Spanish customers are quite active in terms of switching suppliers, with 35 percent of customers stating that they have

switched suppliers at least once over the past three years and more than 14 percent stating they have switched over the past year. (See figure 4.)

One of the most interesting conclusions drawn from the Arthur D. Little survey conducted to utility customers is related to the growth of online channel usage. Customers are using it more and more to gather information on utilities, compare offers and, finally, switch utilities.

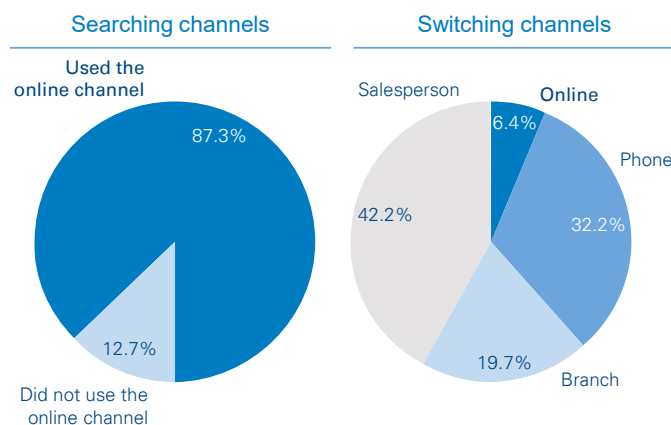
Figure 4: Switching metrics



Source: Arthur D. Little survey and analysis

The growing usage of online channels is especially becoming evident in some activities prior to switching, such as searching for information. More than four out of every five customers state that they compare before switching, and over 87 percent of customers who search for information state that they use the online channel to do so (either exclusively or in combination with other channels).

Figure 5: Online searching and online switching



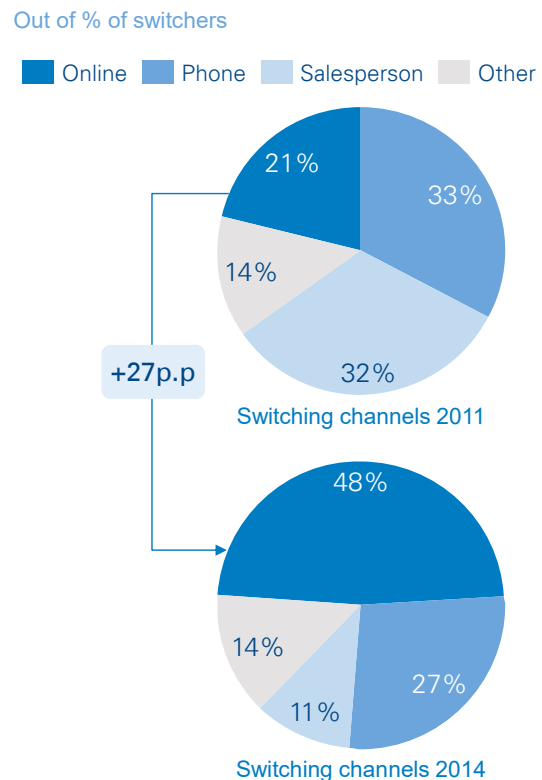
1 Includes outbound and inbound
Source: Arthur D. Little survey and analysis

This impressive proportion of “online searchers” is beginning to materialize into online switchers. Already, 6 percent of those who switched over the past year did so through online channels, while the majority of customers still prefer face-to-face interactions.

This dominance of the online channel for searching for information (well above the telephone and office), combined with the growing digitalization of the Spanish population and considering the similar evolution of other European countries, hints that the Spanish consumer will also move to “digital switching” in the near future.

An interesting example of how fast digital switching can occur is the United Kingdom. Between 2011 and 2014, the number of online switchers grew 27 percentage points, moving from the 21 percent who switched electricity suppliers online in 2011, to 48 percent in 2014.

Figure 6: Online switchers in the UK in 2014 vs 2011



Source: Arthur D. Little analysis, OFGEM

This online growth coincided with the banning of doorstep selling in 2012 after the Competition and Markets Authority (CMA) found that customers were paying higher bills when signing up to tariffs via direct sales. Although such a decision has not been taken yet in Spain, a similar debate has already begun, especially in certain areas such as Catalonia, one of the main regional markets. The local government has begun evaluating the possibility of banning telephone and door-to-door sales.

There are multiple reasons explaining how and why online adoption is happening at such a fast rate in different markets.

Some of these reasons come from the demand side, while others arise from the supply side.

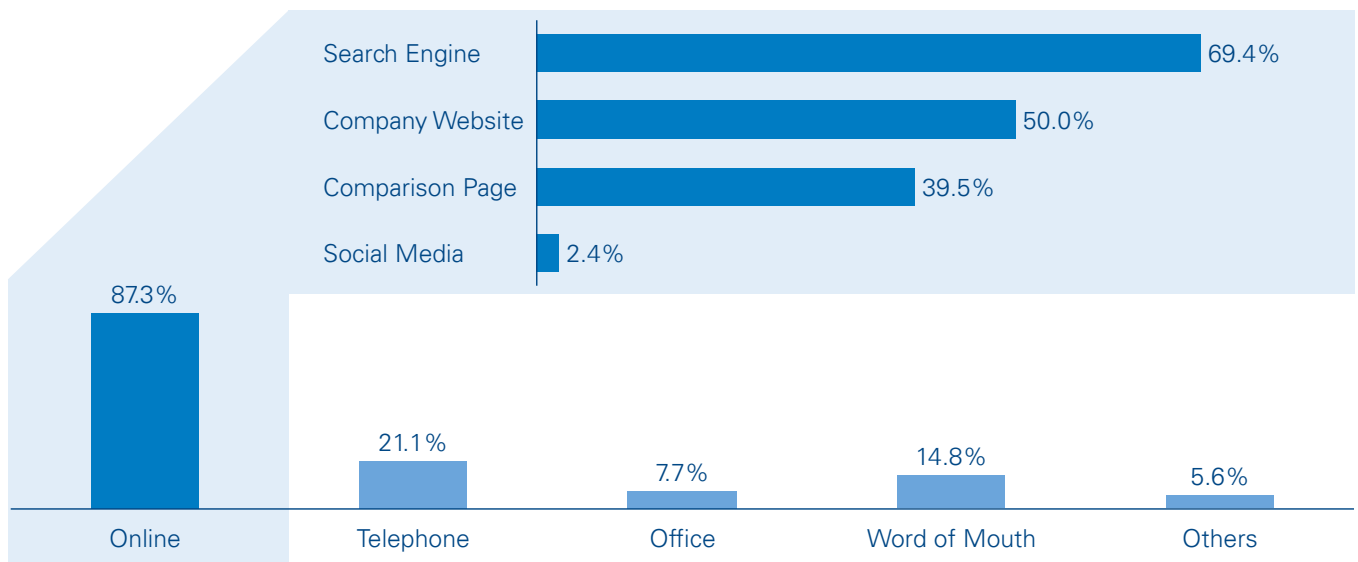
One of the triggers of this shift is that online channels are where some of the “best-priced deals” are found, in both electricity and gas. Customers’ main online comparison tool is the search engine, and comparison websites are also spreading rapidly in Spain, with over 40 percent of customers who search for information online already using them. These two elements will require utilities to reconsider their commercial approaches.

Although there are several drivers for this shift, the conclusion is clear. Utilities need to get ready to manage substantial shifts in their channel mixes.

As our research shows in the next section, Spanish incumbent players are not yet ready for the radical changes ahead, and must prepare for action.

Figure 7: Channels used for comparing

% over respondents who compared information



Source: Arthur D. Little survey & analysis

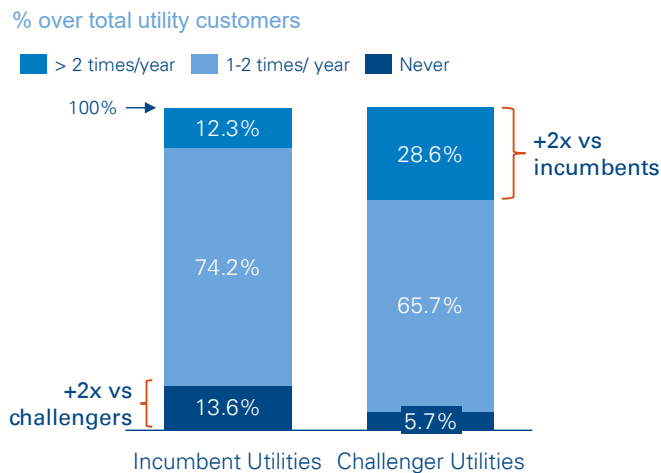
2. A wake-up call for incumbents

In a context where digital is becoming the norm, new challengers are threatening incumbent utilities by adapting their customer experiences and online channels to the evolving customer requirements not only faster, but also better.

Strengthening the online channels as consumer habits evolve will allow incumbents to increase engagement, optimize costs and capture additional customers.

This ability to adapt to the evolving consumer behavior becomes evident when analyzing contact frequency among incumbent and challenger utility customers.

Figure 8: Contact frequency with utility supplier



Source: Arthur D. Little survey and analysis

As seen in Figure 8, customers from challenger utilities are engaging the most with their suppliers. They have two times as many customers who contact them more than twice a year as those of incumbents. Additionally, incumbents more than double challengers in customers who never contact them.

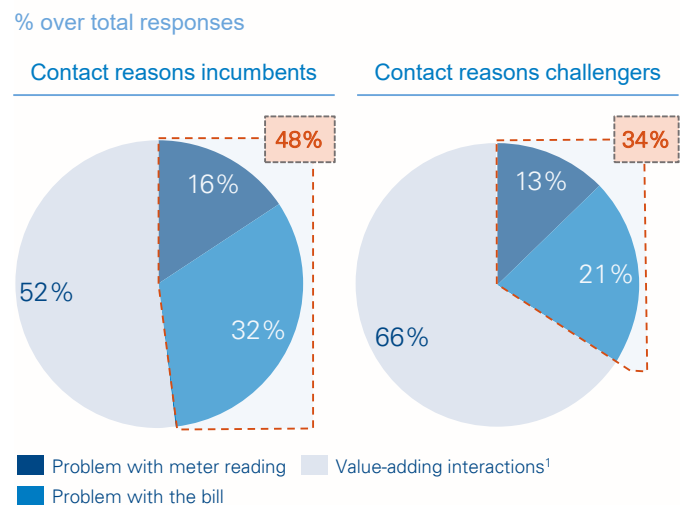
The utility sector has traditionally not been regarded as an engagement-intensive industry (in comparison to banking or retail, for example).

Engagement, however, is not only about the contact frequency with the customer, but also generating valuable interactions.

Incumbent utilities have less value-generating interactions than challengers do

While with incumbents, 48 percent of the time a customer contacts the utility in a non-value-adding interaction (regarding a problem with the reading or bill), this percentage is reduced to just 34 percent among challenger utility customers. With challengers, value-generating interactions (new sales, information about a service) and administrative activities (change of contract or payment method and others) are performed the remaining 66 percent of the time.

Figure 9: Contact reasons



Source: Arthur D. Little survey and analysis

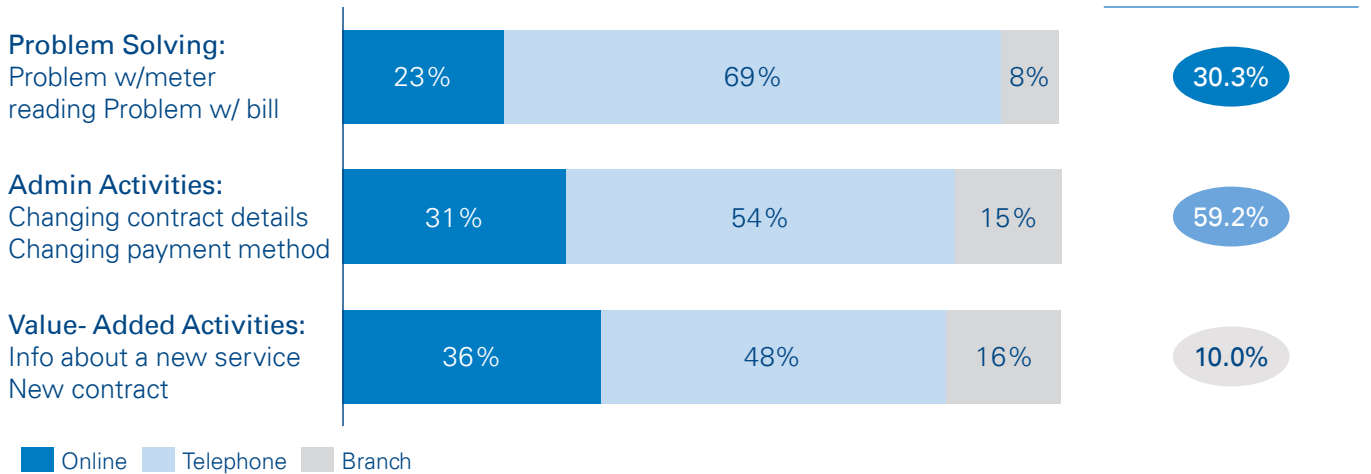
Nevertheless, it is noteworthy to state that these non-value-adding interactions represent a critical touch point and, if not resolved correctly, will greatly damage customer experience.

Overall, telephone remains the preferred channel for contacting utility companies, with 59 percent of customers choosing it.

When contacting the supplier due to problems with the meter reading or bills, telephone appears to be the natural choice for most customers (~70 percent), while the online channel is just used 23 percent of the time.

Figure 10: Channel chosen for each interaction

Channel chosen for each contact type



Source: Arthur D. Little survey and analysis

Usage of the online channel increases almost 10 percentage points when customers want to perform activities involving changing contract details or payment method, and its usage reaches 35–40 percent for activities such as obtaining information about a service or signing a new service contract.

Incumbents’ online channels are lagging behind those of challengers. In order to bring them up to speed, they must meet a series of customer “must haves”

Similarly to engagement levels and customer satisfaction, challenger utilities’ online channels are consistently outperforming those of incumbents:

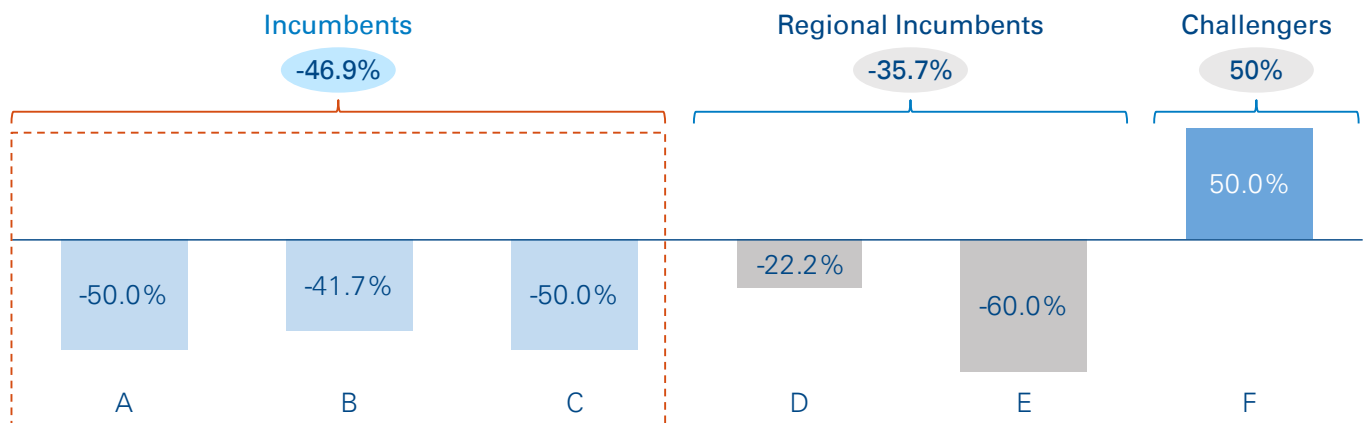
The latter achieve an average Net Promoter Score® (NPS®¹) for their online channels of -46.9 percent, while challengers achieve a +50 percent NPS®.

Challengers’ online channels appear to be more adapted to customers, allowing them to perform several different actions through a more convenient and responsive portal. This difference with respect to incumbent utilities becomes evident when analyzing some key online engagement metrics.

Concerning the number of visits per month per customer to their websites, Spanish challenger utilities greatly outperform incumbents. These utilities’ visits per month per customer are,

Figure 11: NPS® (Net Promoter Score®) of utilities’

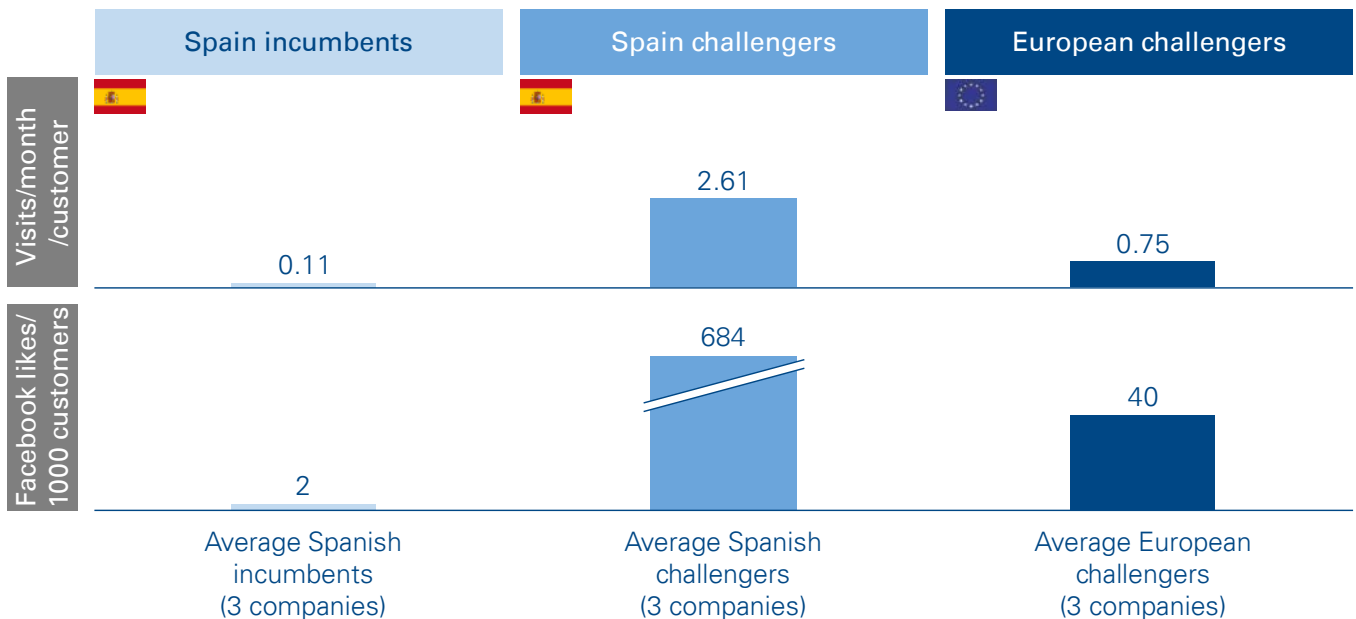
Company online channel NPS®; Average NPS® for each utility group



Source: Arthur D. Little survey and analysis

¹ Net Promoter, Net Promoter Score and NPS are registered trademarks of Bain & Company, Satmetrix Systems, and Fred Reichheld

Figure 12: Online engagement metrics, monthly average



Source: Arthur D. Little analysis, Similar Web, information as of July 2017

on average, 20 times more than those of incumbents. While challengers reach an average of 2.61 visits per customer per month, incumbents only manage to get 0.11 visits per month per customer.

Challengers’ presence on social media, which greatly contributes to generating speedy, timely and useful interactions, is also more significant than that of incumbents. Although anecdotal, it is interesting to point out that while the average incumbent achieves around two Facebook page likes per 1,000 customers, an average challenger reaches more than 680 likes, once again highlighting the great differences that exist in engagement levels between incumbents and challengers. A similar analysis performed with other European challengers suggests that Spanish challenger utilities have better

engagement metrics. However, although it is evident that there is an important gap between incumbents and challengers in terms of their online channel capabilities, it is also true that this gap is by no means insurmountable.

Beyond these particular numbers and ratios at a given point in time, the important conclusion is to realize the tie that exists between engagement, satisfaction and value. The goal for utilities, therefore, is to unlock that customer value by translating engagements into sales.

The key to do so lies in deep understanding of their customers: who they are, what they want and how they want it. These topics will be addressed in the following section.

3. Prepare for action

Even if the way of contacting and engaging evolves, customers will still want what they have always demanded of their utility contact channels: speed, convenience and a hassle-free service. However, with an online switch forecasted for the next years, utilities must prepare themselves if they want to be “part of the game.”

In the described circumstances, utilities and other players willing to have significant roles in the online energy retail business must “get their acts together”

The current utility market’s boundaries are blurring more and more every day. Whether automation, security or comfort for the home, utilities are offering all sorts of products and services beyond “energy”:

The online customer is also becoming used to new standards of service that are not set by regulators, but rather by players such as giant online retailers, which, for instance, offer extremely fast and convenient customer service.

Just as it has occurred in other industries, such as banking and insurance, the online channel in utilities is evolving from a niche or complementary channel to one of the main contact gateways for many customers.

In this sense, there are several key implications that utilities should consider, the main of which are:

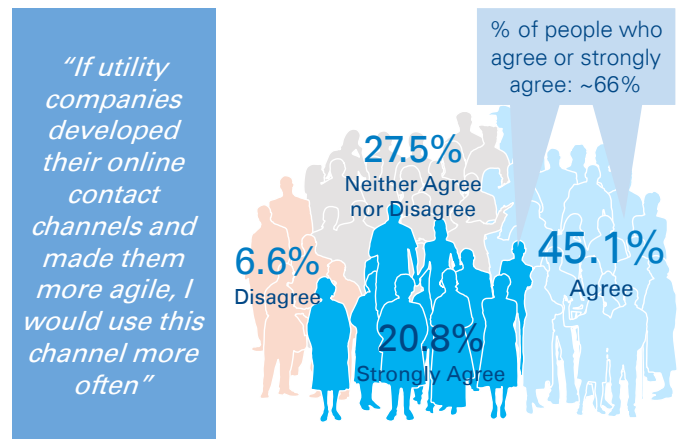
- Understanding which customers to target digital channels to and what their needs are, in order to define a better value proposition
- Rethinking the commercial strategy and how to acquire, retain and generate engagement and loyalty with customers in the new digital environment

Customers are willing to switch to online channels, but they still do not perceive that those of incumbents meet their required needs. However, 66 percent either agree or strongly agree that if incumbents made their online channels more agile, they would use them more often.

As changes in customer habits and attitudes unfold, with a greater demand for speed, agility and convenience, many interactions will “switch on,” moving from traditional offline channels to online ones.

In an industry in which interactions between customers and utilities are generally very sporadic (companies with the highest engagement levels do not register more than two to three interactions per year per customer), it is essential for companies to assure a seamless online channel experience that delivers a consistent service level and meets customer requirements. With few opportunities to interact with customers, companies must ensure they “do it right” every time.

Figure 13: Customer disposition to use online channels



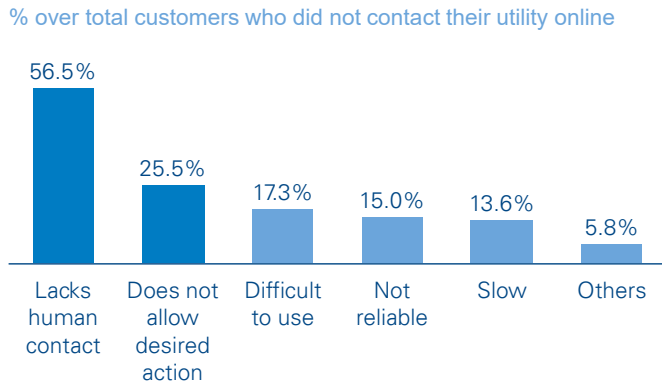
Source: Arthur D. Little survey and analysis

Among some of the main “must haves” of online channels, customers mainly demand:

- Convenience: over 25 percent of customers who do not use their utilities’ online channels state that the main problem is quite basic: the channels do not allow them to perform the desired action
- Speed: Channel responsiveness, intuitive and user-friendly interfaces, and reliability are essential if online channels are to be used

Additionally, among those customers who do not use the online channel, 56.5 percent state that it is the lack of human contact that mainly discourages them to do so.

Figure 14: Reasons for not choosing the online channel



Source: Arthur D. Little survey and analysis

Even if this is an intrinsic trait to online channels, utilities could explore different ways to mitigate this barrier, such as introducing virtual chat rooms or video calls with agents for customers requiring additional assistance or complex tasks to be performed.

Although speed, convenience, clarity, trustworthiness and efficiency, among others, are all attributes that customers demand for the online channel, it is important to note that these are also essential attributes for any contact channel between the utility and its customers.

Furthermore, although this viewpoint has focused on understanding the growth of the online relationship between utilities and their customers, companies should not forget that although it is developing, the online channel is still in an embryonic stage.

There is an additional consideration for incumbent utilities related to their customer bases. For many years, these companies were the only available suppliers, and captured the whole of the market. With the development of the market and the surge of challenger companies, part of that customer base left the traditional incumbent utility, searching for better deals and attracted by challengers' online offerings. The rest of that customer base, including price-insensitive customers who did not want to face the administrative burden of switching, stayed with their traditional utilities.

This diverse customer pool forces incumbent utilities to adopt a comprehensive approach in designing distinct value propositions for each of their different customer segments.

Figure 15: Most desired attributes of the online channel

Size indicates frequency of times the attribute was mentioned



Source: Arthur D. Little survey and analysis

In order to leverage the online channel, utilities must be ready to commit to investments in online presence

Prior Arthur D. Little research performed by the TIME (Telecommunications, Information, Media & Electronics) practice that analyzes advertisement investment shows that online advertising spend has been growing consistently. In Spain, the average spending of each player in the "top 20" online advertisement ranking grew from around 6 million in 2014 to around 7.6 million in 2016.

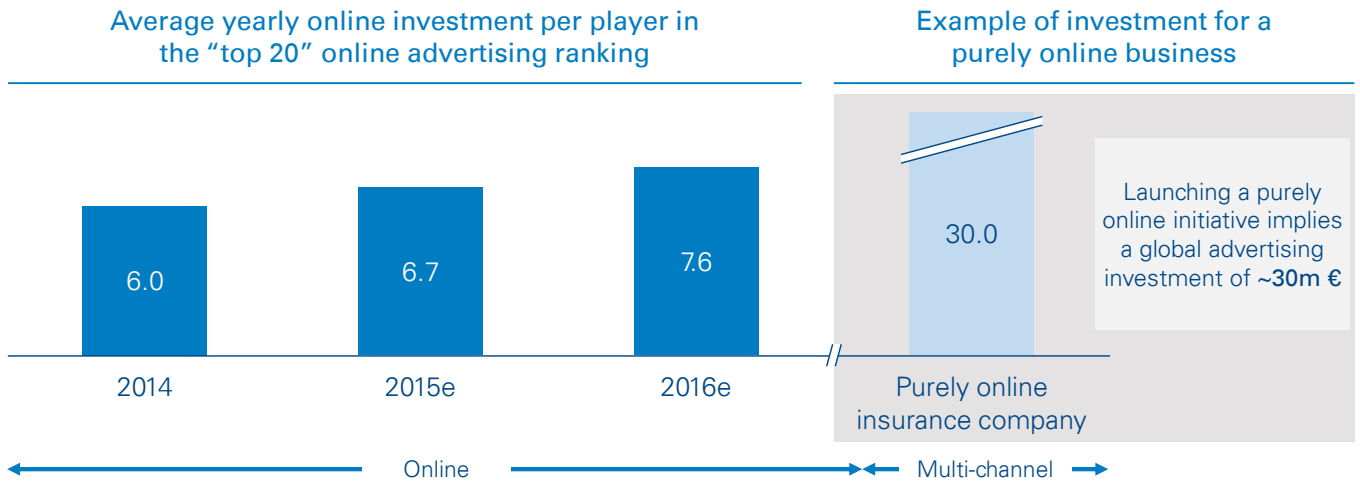
Similarly, through observation and analysis of comparable industries such as insurance, the launch of an insurance company with a purely online value proposition can cost up to ~€30 M per year in advertisement investment.

Although this does not imply that utilities should commit to such investments, it helps to understand the investment ranges that should be considered to achieve different goals in terms of online presence.

However, although investing in online presence is necessary, it is important to keep in mind that if the actual online channels are not functional and adapted to customers' needs, this investment will have little or no impact.

Figure 16: Online advertisement spending in Spain

Millions of €



Source: Arthur D. Little survey and analysis

Insight for the executive

As the utility market's boundaries become more and more blurred every day, customers' digital tastes and demands evolve, and new online competitors enter the market, incumbent utilities must react now.

Our study highlights how increasing engagement (especially online) with customers, not only by contacting them more often, but also by generating value-adding interactions, will increase value and reduce churn. Currently, incumbents in Spain are lagging considerably behind local challengers in terms of engagement with their customers and effectiveness of their online channels.

Time is of the essence in the digital world, and utilities must brace for the challenging task ahead. Otherwise, they will risk losing considerable market share.

As these dramatic shifts unfold, some major questions arise in terms of what initiatives and budgets need to be prioritized by senior management. As in any business facing such a situation, yearly targets need to be met, which require investing

substantial amounts of money in the existing commercial model, as well as management attention. At the same time, building new capabilities in new channels, services and customer mind-sets to target these new emerging segments is crucial in order to continue to be competitive in the near future.

Most power companies have put digital teams in place and are investing in their tools and capabilities. However, as this research highlights, this might not be enough. Beyond digital tools and specific digital initiatives, utilities need to reconsider their commercial strategies in order to differentiate the service offering and the company positioning and defend the margins in an ever-more competitive marketplace.

Arthur D. Little has broad experience in these fields and is currently working hand in hand with its clients to solve these challenges in the utilities industry.

For further details on our analysis and perspectives, please do not hesitate to contact us.

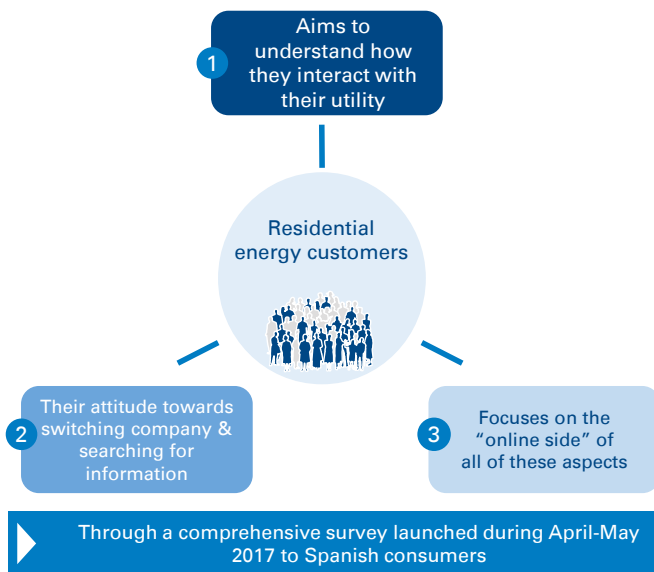
Annex: Methodology & analysis

Aware of the deep changes and digital transformation ahead in the utilities industry, Arthur D. Little prepared this viewpoint in order to help utilities understand the depth of these changes and capture the opportunities derived from them.

In order to achieve this goal, the viewpoint was devised through three main pillars:

- Understand how customers interact with their utilities
- Analyze customers' attitudes towards switching companies and searching for information
- Focus on the "online side" of all of these aspects

Figure 17: Viewpoint design



Source: Arthur D. Little

In order to obtain the most accurate and unbiased information possible, Arthur D. Little resorted to the primary information source. A comprehensive survey was launched to ask Spanish customers directly about these aspects.

This viewpoint is the result of analysis of the answers of more than 500 representative respondents, as well as additional investigation and prior Arthur D. Little utility industry expertise. In order to reach the conclusions showcased in this viewpoint, four main data sources and partners were used:

- A comprehensive survey to utility customers (through an expert market research company)
- In-depth utility website analytics (through online-traffic analysis software)
- Extensive desk research to analyze challenger and incumbent utilities
- Similar international reports on the utilities industry prepared by regulators

Although the viewpoint represents only a selection of the performed analysis, the survey data has allowed Arthur D. Little to obtain a vast amount of data and generate several detailed analyses, including:

- In-depth satisfaction levels of each utility's customers
- Online usage characterization of customers (not only for utilities, but also in other industries, such as banking, telco and insurance)
- Understanding of the main reasons for switching or not switching
- Percentage of customers from each utility who would recommend their supplier

Arthur D. Little has produced a viewpoint that illustrates the current situation of the customer-utility relationship in Spain. It points towards the future and supports utilities in understanding the challenges and opportunities ahead.

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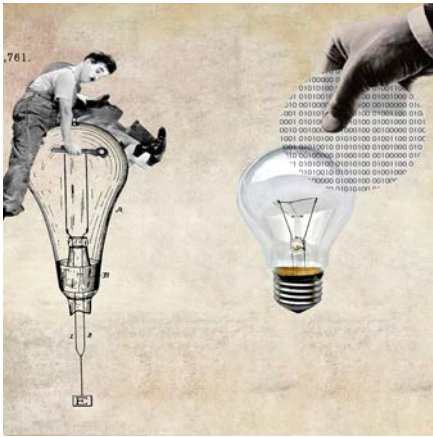
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**“E-lectric” customers – Understanding customers’
online engagement with their power and gas
utilities: The case of Spain**

Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. Arthur D. Little is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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