



Retrofit or Rebuild?

How can utility companies achieve a customer-centric transformation?

Executive Summary – Utility companies need new answers to complex challenges

The market environment for traditional utility companies – both multinationals and SMEs – remains extremely competitive and volatile. Existing business models are not very profitable for sales, and access to new business areas is sluggish and requires major investment. At the same time, utilities are under serious political pressure to find user-friendly and innovative solutions. New digital business models make things difficult for traditional players – they are losing more and more customers to competitors: fewer than one in three consumers get their basic electrical service from one of the “Big 4” energy suppliers.

The enormous pressure this puts on profit margins impacts the bottom line of both B2B and B2C players. Increasingly, customers are also expecting a smooth, holistic shopping and service experience, as evidenced by our 2017 Monitor Deloitte survey of more than 1,000 utility customers.

Energy companies need to respond to these challenges by proactively changing their business. Whether that means a targeted redevelopment of their frontend capabilities (retrofit) or a brand-new holistic business model and technology stack (rebuild) will depend on a company's scale, customer structure and willingness to invest.



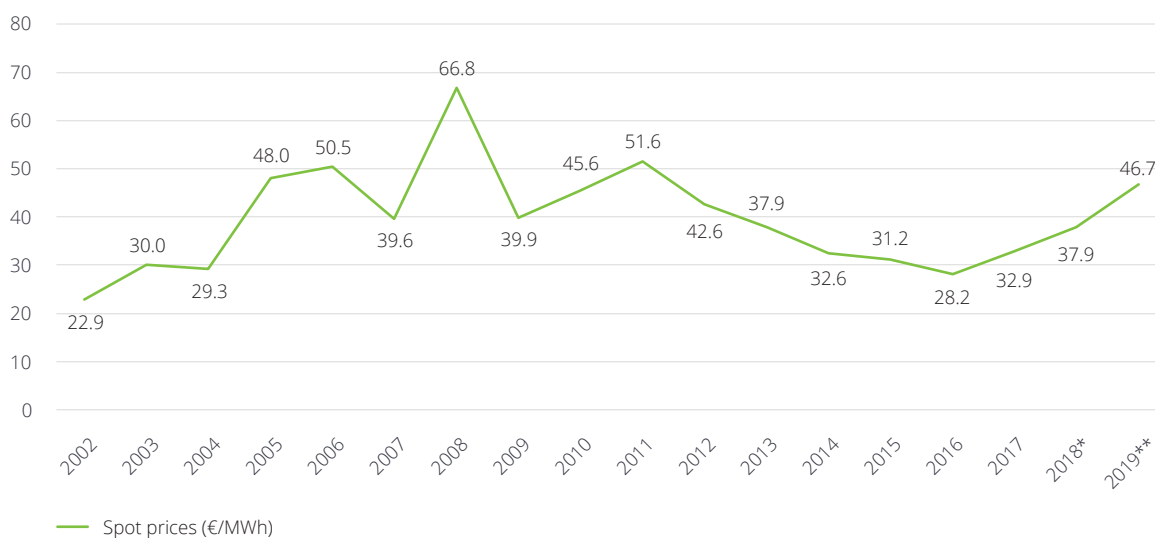
Pressure on profit margins for utilities

Over the last decade, regulations (e.g., liberalization, unbundling, phase-out of nuclear) and technological advances (e.g., smart tech, novel energy storage systems, digital customer engagement) have fundamentally changed the energy market. The sector is facing lower valuations, profits and returns as a result.

The recovery we hoped would save the traditional utility business has never materialized. Any upswing in wholesale prices due to the (expected) phase out of nuclear and coal is structurally capped. And a marginal cost of zero for renewable energies will limit additional price increases to somewhere between 50-60 EUR/MWh by 2030 (see fig. 1).

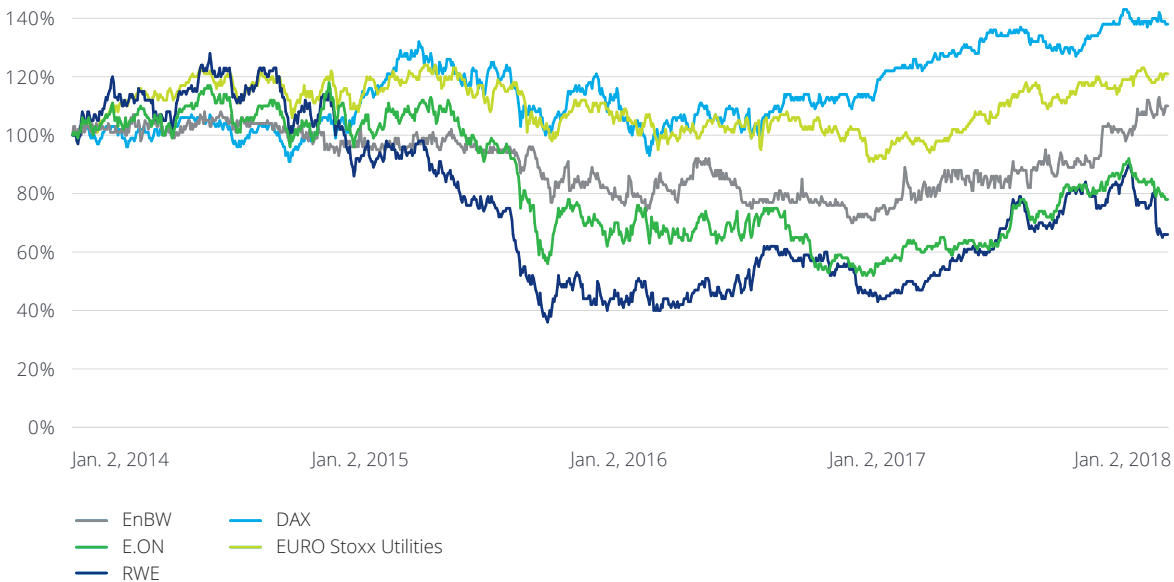
The current market environment makes it virtually impossible for a business focused purely on sales to cover their high overheads and investment costs, which is why we are seeing the energy business move more towards decentralized solutions and services. Large energy suppliers are not well-positioned to operate these innovative, smaller-scale business models profitably. At the European level, this leads to valuations that underperform the market as a whole. For energy suppliers in Germany, the impact is even worse with the additional challenges posed by the energy transition (see fig. 2).

Fig. 1 – Electricity wholesale price
(Average EPEX spot prices p.a., 2002–2019)†



† Average Jan. 1 – Aug. 15, 2018
 ** Phelix Base Year Future on Aug. 15, 2018
 Source: Fraunhofer ISE, finanzen.net

**Fig. 2 – Relatively weak movement in valuations reveal challenges for traditional utility companies:
Valuations of energy supply companies 2014–2018**
(Percentage change since 02.01.2014)



Source: Wallstreet Online, Monitor Deloitte Analysis

It is particularly the relative and absolute profit forecasts that are keeping share prices low. We have seen profitability fall for major energy supply companies over the last eight years. They may also face structural inefficiencies. So, traditional utilities are operating in a low yield environment with no investment signals. Having capital gains close to the weighted cost of capital means they face a loss in competitive edge and limited scope for investment. Integrated energy suppliers

can put their focus on the extended value chain, as indicated by the spin-offs at market leaders E.ON und RWE.

While the scope for topline optimization is limited, energy suppliers have to make a quantum leap in reducing Cost to Serve (CtS), particularly in the commodity business in order to stabilize margins and generate enough earnings to invest in products and customer experience.

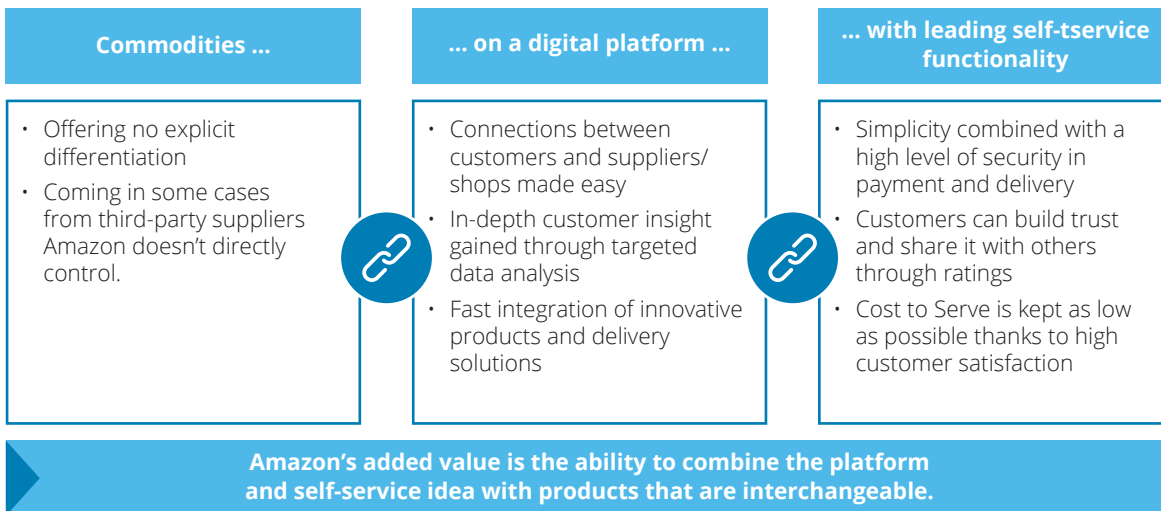
This has not gone unnoticed by new challengers, who are attacking established utilities with digital, cost-effective business models and improved customer experience. We feel a target CtS of €10 is achievable for established utilities willing to embrace a leaner system architecture. Ideally, the focus will be limited to satisfying key needs along the customer journey, as demands are growing for simplified workflows.

Demands from customers

Traditionally, the customer experience with utilities is limited to the annual meter reading. After all, fewer customer touch-points meant lower CtS. Today, customer engagement and value-added services are seen as a lifeline for thinning commodity margins. New and profitable business models can be launched in line with regular amortization cycles of three to five years. However, if they only engage with customers once a year, energy companies will find themselves lacking in one key department: the in-depth understanding of the customer.

Decentralized power generation, digitalization and electromobility are driving industrial convergence. Customers therefore come to expect a multi-channel experience that is simple, whether they are dealing with tech companies or traditional utilities. Simplicity adds value. That is why value-added services need practical design, evidence-based engagement and real emotion. Without any value added by the product itself, it is customer experience that presents a real opportunity, especially for commodity products (see fig. 3).

Fig. 3 – Differentiation of Amazon via the platform and self-service

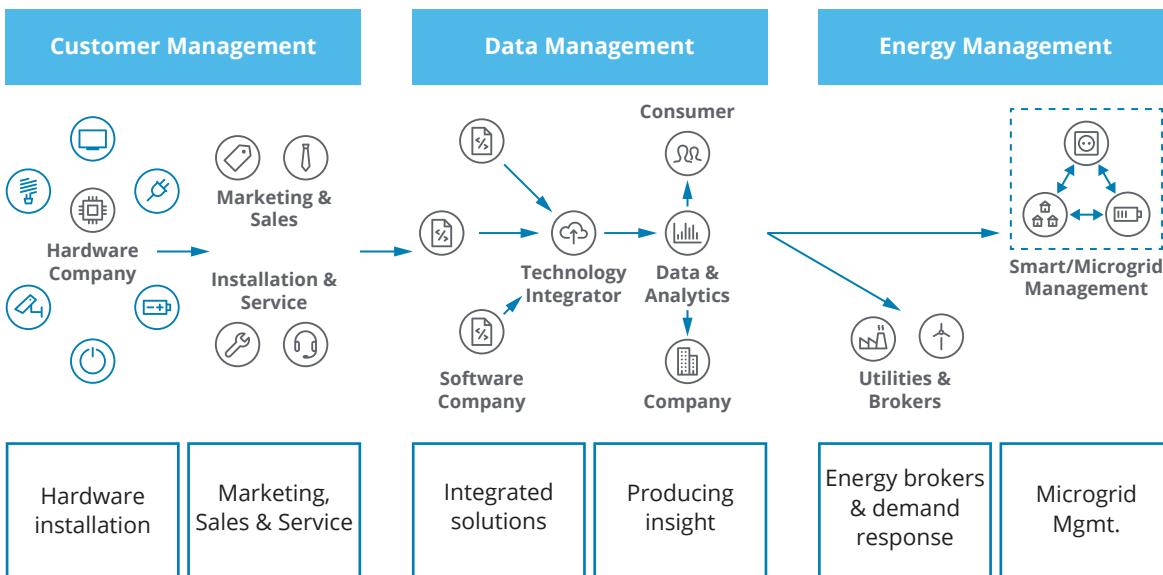


Quellen: Monitor Deloitte, Amazon

The playing field is changing for utilities. Industrial convergence is not a one-way street. Beyond the regular business, more customer touchpoints are needed to access previously untapped business areas. There is certainly opportunity in relationship management, data management and energy management,

but utilities struggle to combine them in a single business model. They need to gather deep insight into various target groups and promote cross-departmental collaboration. This is an enormous challenge for traditional utilities, which can only be overcome with a real willingness to change and strict discipline. (see fig. 4).

Fig. 4 – Business areas with major potential for energy companies



Customer-centric transformation

The first step towards achieving a customer-centric transformation is making customer insight a priority throughout the company as a whole. The personas created for each customer segment must be easy to understand for every single employee. Customers don't make decisions about energy supply contracts every day, but they do see, listen, talk and think about issues. Looking at the challenge from a purely process optimization perspective will not be enough to achieve customer-centric transformation – companies have to derive detailed “customer journeys” for each of their respective personas. This will increase customer satisfaction over the long term and factor in the design, engagement and emotions that motivate customers to choose a potential supplier in the strategic systems architecture for value-added services (see fig. 5).

Taking a customer-centric approach not only applies to direct customer touch-points like sales and customer service, but also to shorter lead times, more multi-channel flexibility and internal data exchange. Transformation will not succeed internally without cross-departmental collaboration and digital support. New digital or customer experience teams do not fail because of a lack of expertise. It is rather the silo mentality of conventional energy supply structures that inhibits integration, buy-in and support for new departments. Customer-centric transformation must be a starting point. Every department has to look at the market through the customer's eyes, not only to appreciate the value they add every day – but also to understand what problems exist from the customer's point of view.

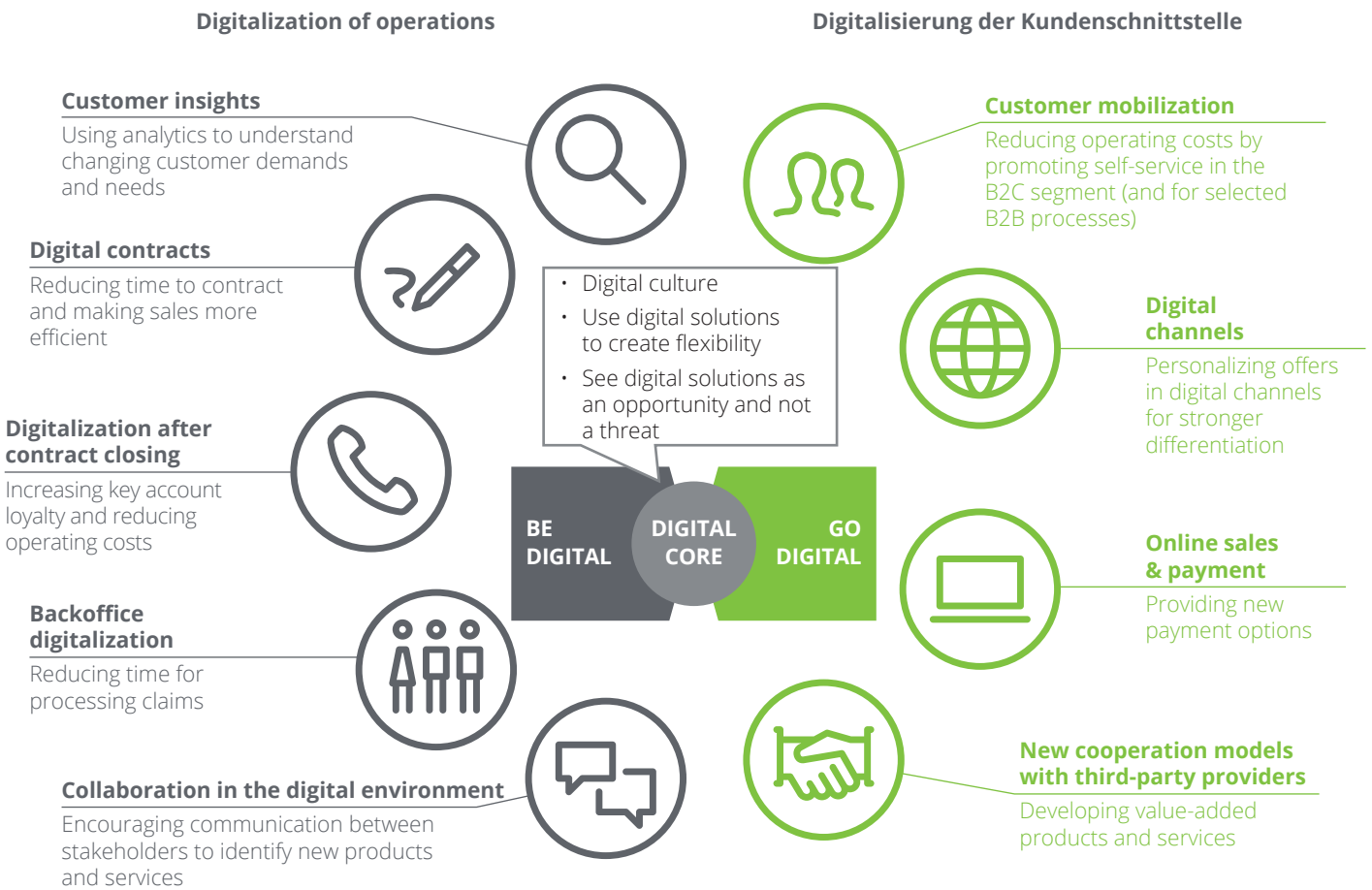
Fig. 5 – Ways to make transformations more customer-centric by optimizing in-house processes



There is no way to achieve customer-centric transformation without a digitalization strategy. The digital backend enables utilities to process and synthesize data that the frontend will need to meet customer expectations.

Establishing a digital core designed in line with customer needs is an essential element of customer-centric transformation (see fig. 6)..

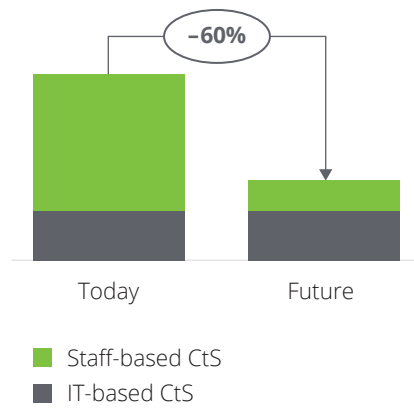
Fig. 6 – Customer-centric transformation along the digital core



In a transformation process, the digital core can be implemented gradually by retrofitting existing systems or by rebuilding the entire process and systems landscape. The utility companies of today prefer a step-by-step transformation within the existing systems architecture, focusing on frontend sales processes and technologies. This can limit the customer focus and pose tough challenges in the change management process, also with respect to costs. Rebuilding requires a substantial investment, yet it also creates a customer-centric digital core in a high-performance process and technology landscape. Through economies of scale, the digital core can reduce CtS after migration costs for households by up to 50% to 10-12 euros per customer per year (see. fig. 7).

In concrete terms, this means converting sales with two clicks instead of 15, taking new value-added services to market in just a few days and raising acceptance rates for persona-specific offers from 3 to 90 percent. A customer-centric transformation enables utility companies to leverage the opportunities presented by industrial convergence and digitalization. They can disrupt the core business from the inside and win the battle for customers. The time is right to launch a customer-centric transformation and ensure long-term success.

Fig. 7 – IT-based CtS stays stable, while drastically reducing staff hours and expenses



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