A CLOSER BOND

BY FOCUSING MORE ON THEIR CUSTOMERS, UTILITIES CAN IMPROVE THEIR REGULATORY RELATIONSHIP AND BOTTOM LINE.

BY MICHAEL BRITT AND GERRY YURKEVICZ

One of our utility clients often states that happy customers lead to happy regulators, which leads to happy shareholders. There is substantial evidence to support his statement. Based on our analysis, if all shareholder-owned utilities were equally effective in focusing on the customer and building their brands, their collective annual earnings would be $5 billion higher.

But the task of tapping this earnings pool will become increasingly difficult and complex as utilities face the issue of rising infrastructure costs during an economic downturn. Utilities that are not customer-focused may face a much more engaged and involved customer, which could have an impact on regulators and, in turn, place future earnings growth at risk. It is a potential flashpoint, and utilities will have to focus on enhancing the customer experience and building their brand by simplifying and improving their interactions with customers. To gain a share of that $5 billion, utilities will

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need to develop new integrated, customer-centric approaches to their strategic, market, regulatory, and financial planning.

The Customer-Brand Connection

The link between the customer and utility financial performance is real and significant. Electric and natural gas utilities that are better at providing a good customer experience and building a strong brand deliver long-term return on equity (ROE) about 1.7 percent above the rest of the pack, according to an Oliver Wyman analysis of customer experience, branding, customer satisfaction, and reputation among North American utilities. It pays to focus on building a strong customer brand by providing a superior customer experience:

■ Electric and natural gas utilities that outperform their peers at positioning, branding, and satisfying the customer achieved average ROEs of 12.3 percent from 2006 to 2010.

■ Top-performing utilities earned ROEs 1.7 points higher than utilities "in the middle." These incremental returns do not occur all at once. They typically reflect years of strong customer focus, brand management, and regulatory initiatives to deliver superior results.

■ The worst-performing utilities do not suffer significant penalties. Both utilities "in the middle" and "worse" on the customer scale earned a five-year ROE of about 10.6 percent. Allowed returns embedded in rates provide a floor on earnings levels, which conceivably insulates companies from the impact of inferior customer focus.

There are several pathways from a better customer experience and utility brand to superior financial performance. Satisfied customers both directly and indirectly benefit shareholders:

■ Customers who are more satisfied directly contribute to higher demand with greater energy consumption, expansion of business operations, or participation in utility programs and services. Satisfaction also leads to advantageous end-use appliance and equipment decision-making and to better partnerships with trade allies and suppliers.

■ Greater customer satisfaction leads indirectly to greater customer acceptance of utility service issues. This is especially important since electric and gas service is generally considered to be a "lower involvement" category of spending by the customer, as it represents a small but growing percentage of household income. Most consumers do not spend more than a few minutes—if any time at all—contemplating their utility service. This low level of involvement translates to lower levels of involvement in and negative impact on the regulatory process.

Satisfied consumers typically help satisfy regulators and politicians. As a result, utilities are in a better position to receive more "constructive" regulatory treatment. Often, this includes mechanisms and frameworks that enhance utility returns and/or lower risks of under-recovery (such as capital and expense trackers and generous earnings-sharing arrangements).

Managing Expectations

Utilities need the help of their customers and regulators to support spending plans, ratebase growth, and earnings growth to meet regulatory obligations and shareholder expectations. Over the period 2005-2010, the "back-to-basics" strategy of most utilities led to annual capital spending on net plant (a good proxy for ratebase growth) of about 8 percent and earnings growth of 6 percent to 7 percent. This earnings driver is expected to continue. From 2010 to 2015, electric and natural gas spending on net plant is expected to average over 4 percent annually, driving an equal increase in annual earnings. Utilities that are more successful with the customer and regulator will see higher levels of allowed spending and earnings growth to maintain or improve aging infrastructure or meet environmental requirements.

Unfortunately, there is a scenario where this beneficial customer-regulator-shareholder relationship breaks down. Examining where spending on

A good customer experience improves a utility's long-term ROE by about 1.7 percent, according to the authors.

Courtesy: ConEd

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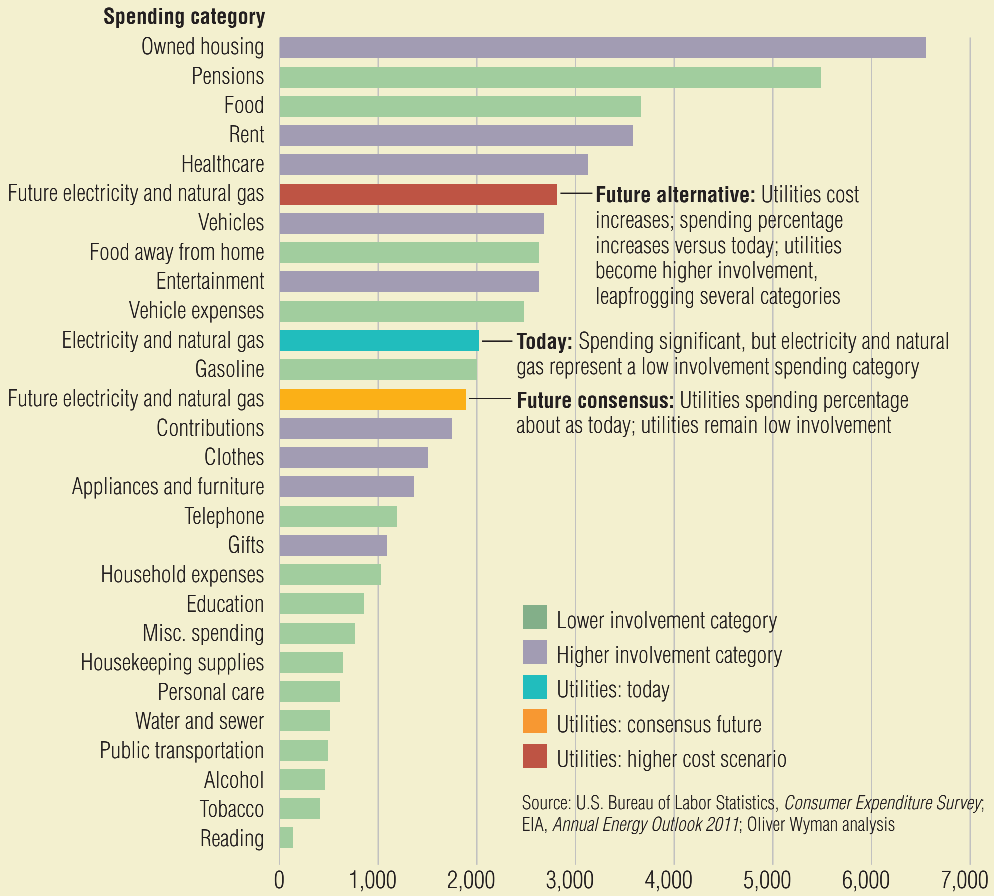
FIGURE 1

AVERAGE ANNUAL HOUSEHOLD SPENDING (Dollars)



Source: U.S. Bureau of Labor Statistics, *Consumer Expenditure Survey*; EIA, *Annual Energy Outlook 2011*; Oliver Wyman analysis

electric and natural gas fits in with overall consumer spending sheds light on what a difficult time utilities are likely to face in the future.

Based on our analysis of U.S. households, the electricity and natural gas category sits about in the middle of the spending spectrum—on average, about $2,000 a year. Again, utility spending is a low-involvement category—consumers typically do not want to devote much time, thought, energy, or resources to the purchase process. Utility spending is similar to other low involvement categories such as gasoline, restaurants, and food. Spending tends to be greater for higher-involvement categories such as owned housing, healthcare, and vehicle purchases. (See Figure 1.) Though electricity and natural gas spending is generally lower involvement, it is not an insignificant amount—averaging 4.1 percent of household income. (See Figure 2.) (See sidebar, "On the Electric Side.")

What does the "business as usual" view of the future look like? The consensus view is for utility services spend to remain high but fairly flat over the next five years. This view suggests that the cost of capital investment for new renewable as well as nonrenewable generation and transmission and distribution infrastructure will be offset by price decreases due to a slow-growth economy, abundant natural gas supplies, energy efficiency, and cost-reducing technological change.

But several factors could change this expectation of flat spending. Any combination of pending regulatory rules from the Environmental Protection Agency, reduced recovery per shale gas region or production well, financing difficulties with shale production, lower consumer acceptance of energy efficiency measures, or higher costs of rebuilding the aging electric and gas infrastructure could well reverse the situation. This scenario could drive relative consumer spending on utilities to almost 6 percent or more of household income. If this were to happen, utility spending could leapfrog other categories, such as entertainment and vehicle purchases, and begin to approach healthcare in significance. At this higher level, spending on utilities might evolve from a lower to a higher level of involvement in the eyes of the customer. Future utility earnings could be put at risk by the increased scrutiny and involvement of customers, particularly if it leads to political pressure on regulators to keep rates low.

New Focus

If the customer plays such a critical role as the driver of future earnings, utilities should consider how they will improve their bond with him or her.

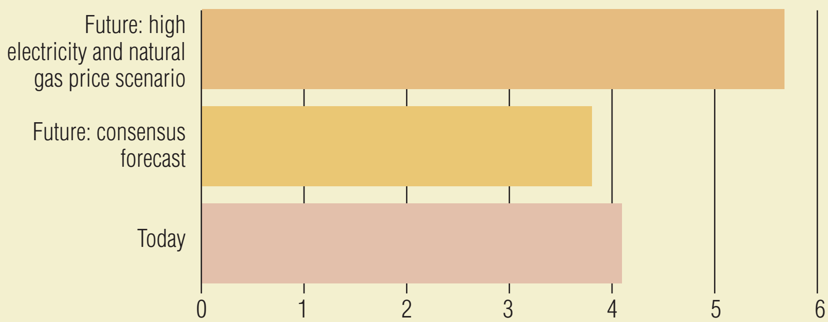
One suggestion is to focus on man-

On the Electric Side

The statistics cited in this article are for electricity and natural gas combined. According to the 2011 *Edison Electric Institute Statistical Yearbook*, the average residential customer paid $1,327 per year on electricity alone in 2010. According to the Census Bureau, the median household income in 2010 was $49,445—meaning that the average annual electric bill was 2.7 percent of income that year.

FIGURE 2

HOUSEHOLD SPENDING ON ELECTRICITY AND NATURAL GAS
(Percent of household income)



Source: U.S. Bureau of Labor Statistics, *Consumer Expenditure Survey*; EIA, *Annual Energy Outlook 2011*; Oliver Wyman analysis

aging customer interactions with the utility in a holistic fashion across multiple dimensions, including payment centers, contact centers, websites, social media, and automated interaction through programmed devices.

To this end, it is important to understand and invest in those customer touchpoints that are critical to enhancing the customer experience and building the utility brand. The 80-20 rule—in this case, that 80 percent of your benefit generally comes from 20 percent of your touchpoints—very much applies: Not all touchpoints equally influence customer behavior. You must establish a realistic and accountable process for managing key customer touchpoints, investing smartly, and measuring results.

Many utilities have embraced a more customer-centric model, with the creation of chief customer officers or vice presidents of "the customer experience" on organization charts. Frequently, however, these efforts are too narrowly focused: Creating a few new positions and then focusing only on, say, contact center touchpoints (such as the introduction of a new customer relationship management system) while ignoring other critical aspects (such as customer-related reliability issues) will create some value but misses the opportunity created by a more holistic view. To position the utility to capture these benefits, you must address customer touchpoints in an integrated fashion.

Utilities often launch cost-reduction efforts, consolidation, or standardization under the guise of customer improvement. This is because the traditional view has been that customer service and interaction are cost centers that must be managed and reduced rather than cultivated as an opportunity. We advocate a balanced approach: Management focuses on the types of interactions that truly matter to improve the customer experience and brand, but learns from each customer contact.

A holistic view of touchpoints allows a more tailored solution for customers. This can increase customer satisfaction and reduce costs, because solutions are achieved efficiently, with better information available to the customer and the utility professional at key touchpoints.

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Improving the experience. Key utility customer touchpoints include customer service, contact center performance, and word of mouth.

Customer Segmentation

Insights from effective customer segmentation more effectively help build customer relations, despite the scale issues of developing meaningful customer connections in the lower-involvement mass market.

As is the case for most customer-focused programs, drawing insights and tailoring solutions based on the needs and characteristics of customer segments is crucial to designing a robust customer experience and to building the utility brand. You need to collect, maintain, and efficiently analyze the avalanche of customer data from all of the individual customer touchpoints. (See Figure 3.) To lay the foundation, it is often necessary to create an analysis engine to enhance data collection

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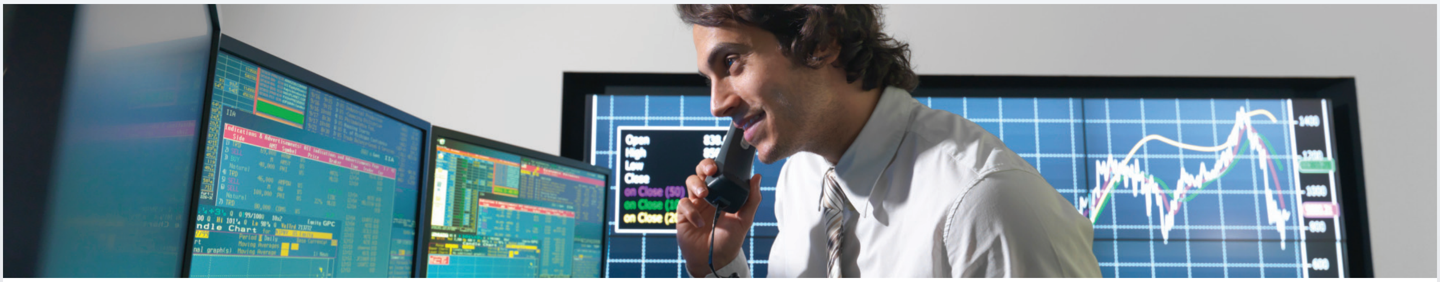

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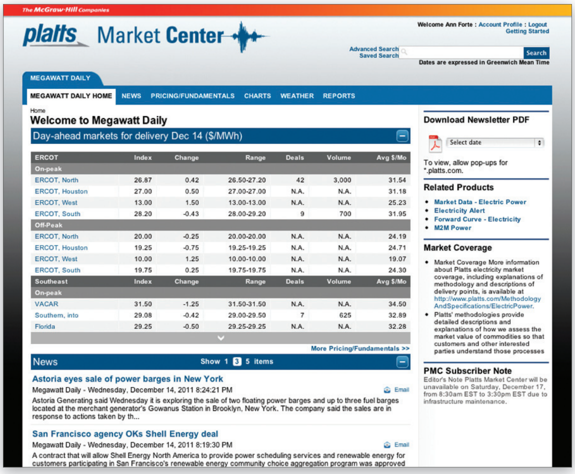

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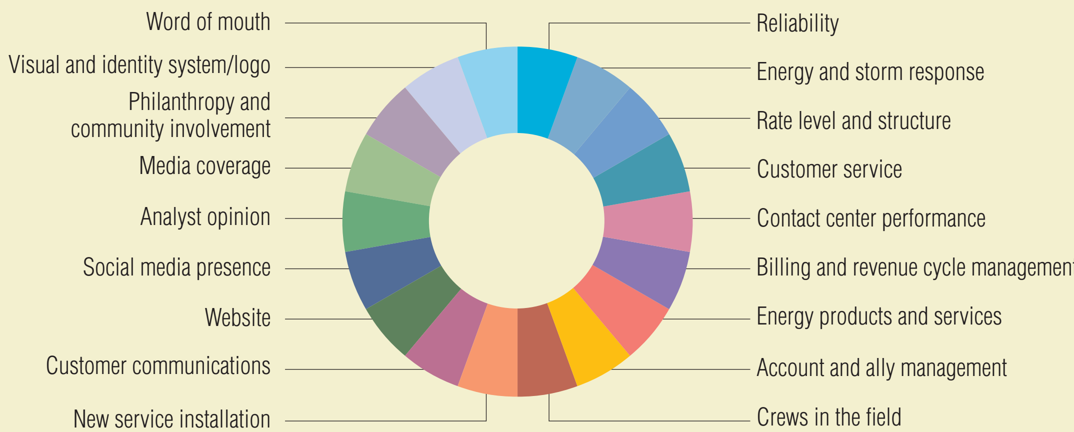
FIGURE 3

UTILITY CUSTOMER TOUCHPOINTS AND BRAND EXPERIENCE



Source: Oliver Wyman

and management in support of the segmentation efforts.

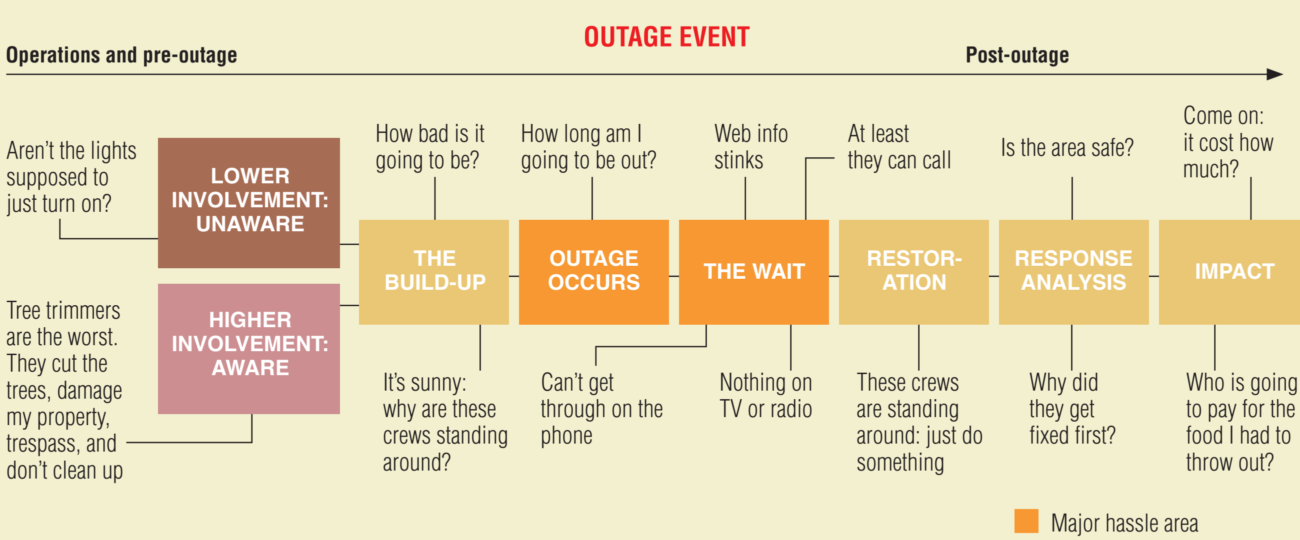
Consumer Demand Engineering

In the same vein, utilities could embark on a new wave of customer research and analysis, using such tools as "hassle maps" to design products and services that are solution-focused. Other industries have created compelling customer-focused products and services before the customer understood what they really wanted, using demand engineering. From our research, successful companies in those industries all share an ability to experience the world through the eyes and emotions of customers. These companies catalog every frustration, time-wasting complication, and source of uncertainty. Successful companies watch their customers use their products to get the most value—because people do not always have the ability to express their specific energy-related needs beyond "low-cost," "reliable," and "clean." Finding commonalities across segments to connect the dots driving consumer behavior leads demand creators to bridge the huge gap between what people settle for and what they really want, spawning such demand "stars" as Apple, Zipcar, Google, Netflix, Nespresso, Amazon, and CareMore. Utilities can learn from such companies.

A "hassle map" is a tool used to better understand the customer experience. (See Figure 4.) Mapping customers' hassles with utility service should be a top priority. Customer hassle maps should help set the utility agenda to design products and enhance service delivery across customer touchpoints. Working to eliminate or minimize major service hassles drives the business priorities of successful innovators and creates the environment for significant future value creation.

FIGURE 4

STORM OUTAGE AND RESPONSE HASSLE MAP



Source: Oliver Wyman

Enhanced Regulatory Strategy

Regulators represent the utility's most important key account, and the utility continuously should seek to enhance its understanding of their evolving needs and objectives. It may be difficult to do in some jurisdictions, but one suggestion is that utilities consider developing regulatory hassle maps, for both their commissions and key government entities. A utility should ask "what do regulators hate" about how the utility carries out its business and delivers service. As for other customers, the utility should catalog frustrations, time-wasting complications, and sources of uncertainty or irritation. It also should segment regulatory areas—thinking about hassle maps differently for commissioners, public utility commission staff, consumer advocates, and other key influencers of the regulatory process. Where possible, it should seek to eliminate the impediments to improved regulatory relations and enhance the potential for collaboration on constructive regulatory outcomes.

The Customer as Part of the Plan

Our research suggests that the customer should play a larger role in utility planning and decision-making. A customer-centric strategy that is comprehensive will extend from the company's operational, financial, and regulatory processes through to its strategic planning. Too often, we see utilities merely asking what the "customer bill impact" will be of a certain strategic option. To integrate the customer more directly into all aspects of the planning effort involves such questions as

- what customer initiatives and programs should we undertake that mitigate the major hassles of our key customer segments?
- what incremental returns should we expect if we implement these customer-focused initiatives?
- how much do we leave on the table or lose by not trying to enhance the customer experience and utility brand attributes?
- what are the tradeoffs among customer experience-building efforts and cost reduction initiatives in meeting our targets?
- what are the market, regulatory, and financial implications of higher levels of customer involvement in utility purchasing decisions?
- what planning assumptions and results should we challenge if we use a more customer-centric lens?

Answering these questions will go a long way in determining whether a utility will share in the $5 billion in additional earnings available to those that successfully focus on the customer. ◆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