

DEVELOPING CUSTOMER PARTNERSHIPS IN A COMPETITIVE ENERGY MARKET

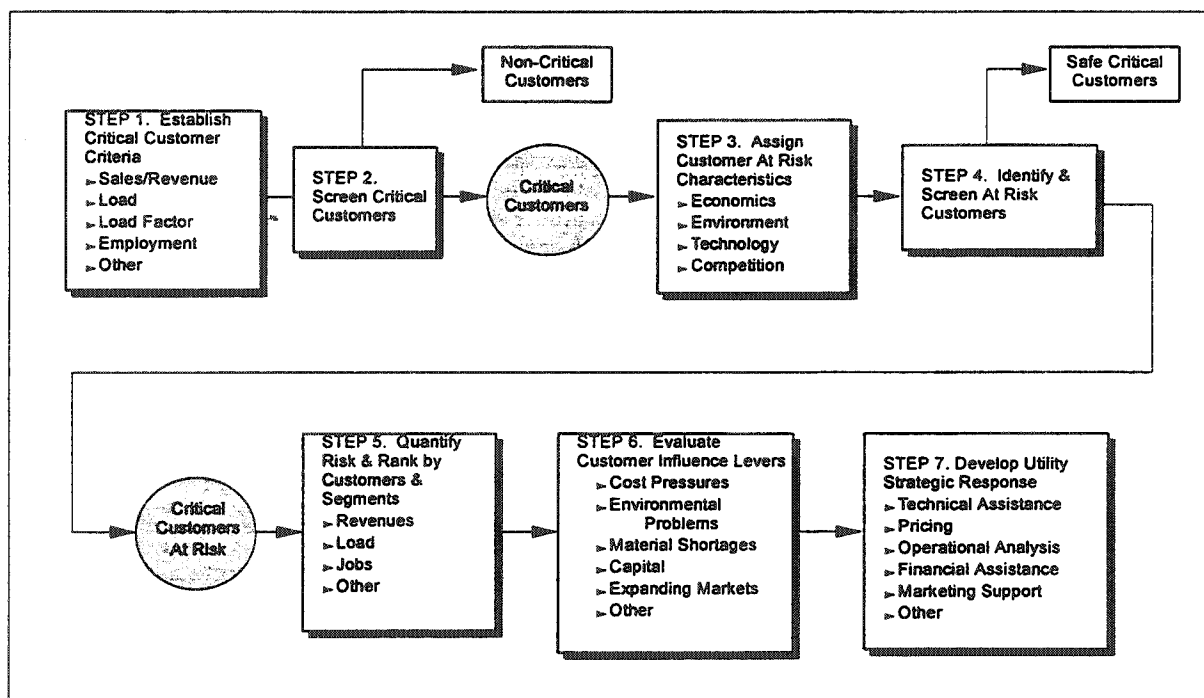
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The energy business is changing more rapidly than anyone predicted even three years ago. It has shifted from a business of accommodation, to a business of helping customers (even paying them) to use less of the primary product -- energy, to a business of offering some value-added products and services to customers. Today, the electricity supply business is often described by some as a commodity supply activity, with limited use of value-added products. This is not necessarily true.

As a utility examines its customer base, it is increasingly critical to identify those customers and customer revenue streams that may be "at risk" -- at risk from going out of business, shifting production locations, environmental regulation, technology and fuel substitution, retail wheeling, or customer self-generation. Evaluating these risks can help a utility in developing strategy options for establishing working partnership with customers where the potential loss in revenue stream is reduced. However, the key to a successful customer assistance strategy is to focus on the improvement benefits that can help the customer increase their competitive advantage while providing a revenue stream to the utility.

The foundation of the Resource Dynamics Corporation (RDC) Customer-At-Risk Evaluation® (CARE) service is to identify at-risk customers with real business needs -- needs that can be satisfied by a product or service solution building on the utility's proven capabilities. The CARE® service focuses on customers that are both *critical* to utility performance and *at-risk* from poor industry or segment economics, environmental regulation, technology substitution, and/or competition.

Figure 1. The CARE® Program Approach



THE CARE® APPROACH

CARE® is a 7-step process that 1) establishes the “critical customer” criteria based on utility corporate goals, 2) identifies critical high value utility customers, 3) assigns at-risk characteristics to each of the critical customers, 4) identifies and screens the critical customers at risk, 5) estimates the value of the revenues at risk, 6) evaluates customer influence levers, and 7) develops a utility strategy to mitigate or manage the risk (see Figure 1).

Establishing Customer Criticality

The value that different customers offer utilities varies greatly. For example, while two customers could face very similar economic business risks, the customer with a \$5 million annual electric bill is more critical to the utility than the customer with the \$500,000 annual bill. Similarly, the 10 MW load customer is more critical than the 500 kW customer. While utilities must be concerned with the loss of any customer, they must place a priority on customers of higher value. The higher value customers are critical to a utility’s ongoing profitability and viability.

Customers are critical to a utility for a number of reasons. The most important is the customer’s revenue contribution – the utility has a significant investment in plant and equipment assets in place to serve the customer, and the revenue stream from power sales represents a return on this investment. In addition to revenue, other critical customer characteristics include load (demand), load factor, and employment. As part of the CARE® program, we work with utilities to select the criteria that are most important, taking into consideration corporate goals, sales trends, authorized rate of return, and financial performance. Appropriate criteria measures are then established, reflecting customer contribution to total sales, load, system load factor, and other factors identified by the utility. Typical critical customer criteria measures are summarized below in Table 1.

Table 1. Critical Customer Criteria

Criteria Measure	Description
Sales/Revenue	The customer revenue stream drives the bottom line of utility performance, and is generally regarded as a proxy for company profits.
Load	Load (or demand) is a measure of the customer’s temporal requirement for utility generating capacity. The major portion of most larger customer revenue streams is driven by customer demands.
Load Factor	Load factor reflects the “peakiness” of the customer’s load profile. High load factor customers (with a relatively flatter load profile) represent greater revenues than similarly-sized more variable customers.
Employment	The utility’s service area employment base is a dominant force behind local economic prosperity and business success. The “multiplier effect” of commercial and industrial customer indirect employment is a foundation of the service area economy. In some states, the utility is a major force behind economic development.

Assessing Customer At-Risk Characteristics

Customer risk can manifest itself in a number of undesirable outcomes, including:

- Economics*
 - ▶ plant closing or capacity reduction from adverse business conditions or lack of profitability
 - ▶ production shift from local plant to another facility with a competitive advantage
- Environmental*
 - ▶ plant capacity reduction (or closing) from changing and more stringent environmental regulation

- Technological* ▶ substitution of non-electric technologies and fuels
- Competition* ▶ customer self-generation
- ▶ retail wheeling.

Most of these potential outcomes are well-recognized by utilities. What is less difficult to identify are the specific customer characteristics that make the customer more vulnerable or “risky” than other customers. Examples of customer at-risk characteristics that are examined under the CARE® program include:

Table 2. CARE® Customer At-Risk Characteristics

Category	Criteria
Environmental	Air Wastewater Toxic Releases Solid Waste
Industry Segment	Shipments Revenues Employment Concentration Competitors Industry Profits Import Market Share New/Expanding Markets Contracting Markets
Production Economics	Electricity % Value Added Electricity % Value Shipments Rate Tariff Efficiency Improvement Investment Rate Renegotiation Request
Process and Plant Utility Operations	Customer Service Record Service Reliability Major Load Decrease Heat Requirements Steam Generation Capability Heat to Power Ratio Fuel Flexibility Emergency/Backup Generation Primary Power Generation
Geographic	Proximity to Substation Proximity to Transmission Line Access to Natural Gas Proximity to Gas Compression Station
Institutional	National Company Sister Plant Locations Production Slate Flexibility Rate Case Intervenor Trade Association Activity Political Activity/Influence Union Contract Employer

Customer Influence Levers and Utility Strategic Response

As discussed, utilities must be concerned with customers that are both *critical* and *at-risk*. Once a customer has fallen into the critical, at-risk category, the CARE® program evaluates customer influence levers that can be subsequently acted on by the utility to mount a strategic response. Customer influence levers are internal and external forces impacting customer operations and business decisions. The specific influence levers differ among industries and companies, but generally fall into one of the following categories:

- ▶ **Competitive Position**
 - Market dynamics and market reach
 - Production efficiency
 - Total production costs

- ▶ **Capital**
 - Capital availability
 - Cash flow

- ▶ **Labor**
 - Labor force dedication
 - Skill cross training
 - Operating shift flexibility
 - Cost stability

- ▶ **Energy and Environment**
 - Environmental problems
 - Total energy costs
 - Cost stability
 - Energy supply flexibility and reliability

- ▶ **Material**
 - Raw and intermediate material supply
 - Cost stability

Customer criticality and each customer's "at-risk" measure (see Table 2) can be assessed at various levels (e.g., high, medium, low). Each combination of customer criticality and at-risk rating yields a strategic response by the utility that can be designed to act on an influence lever and mitigate or manage a customer's at-risk characteristic(s).

CARE® CASE STUDY

As an example of the CARE® process at work, RDC identified at-risk customers and examined their business needs for a major Midwestern utility. Based on utility corporate goals, the utility chose to focus on a single "critical customer" criterion -- sales/revenue. The initial screening of their top 50 customers identified a subset of customers determined to be both *critical* and *at-risk* based on the criteria discussed previously. A second level screening was then done -- using customer-specific research and data -- to determine the ten customers most "at-risk".

The results indicate that opportunities exist for the utility to help at-risk customers improve operations and comply with environmental regulations while possibly increasing sales. Potential utility services identified throughout the process include: increased system reliability, cogeneration planning, environmental management, trade ally programs, customer waste exchanges, alternative customer procurement options, shared savings investment options, and customer marketing support services. A comparison of "at-risk" customer findings for the ten customers found to be most "at-risk" in the key influence lever areas follows.

Reduce Costs

Less than half of the most "at-risk" customers are energy-intensive industries sensitive to the cost of energy.

Overall results showed that electricity cost was a concern for all of the at-risk customers except one. Although electric cost is important, half of the most “at-risk” customers are more concerned with reliability issues. A final concern for the utility is for those customers that are potential targets for the utility’s competitors. Customers with corporate linkages (i.e., headquarters or sister facilities) located within a competitor’s service territory, having their own substations, or being served close to a transmission grid are all potential targets for the utility’s competitors. Six of the ten most “at-risk” customers fall within a competitor’s target area.

Possible Utility Solutions. The utility may look into offering their “at-risk” customers within this category services such as: discounted pricing structures for the more energy-intensive customers, increased system reliability, cogeneration planning, increased facility efficiency through conducting facility audits, and other value-added services.

Environmental Assistance

Nearly all of the utility’s most “at-risk” facilities – like those throughout the country – are facing increasing competitive pressures due to the costs of complying with environmental regulations. As a result, virtually all of the facilities are in search of the least costly alternative. At the same time, the range of compliance options is changing regularly, with new technologies being developed, demonstrated, or commercialized to solve environmental problems.

Possible Utility Solutions. The utility may consider offering environmental assistance – through customer seminars, facility audits, or technology briefings – to their at-risk customers to help them face their environmental challenges. In providing these customers with information on new electrotechnology solutions to environmental problems, the utility has the potential to increase or stabilize their load. In addition, the at-risk customers benefit from the knowledge of new options that may better meet their current needs as well as help them comply with future changes in regulations.

Resolve Material Issues

Material issues are considered to be any material item – raw materials, labor, technology, buildings, etc. – that is an integral part of a customer’s operations. Three of the ten customers have no major concerns regarding material issues. However, half of the utility’s most “at-risk” customers are currently conducting or planning technology and/or facility upgrades. Labor issues are also a key concern for 3 of the most “at-risk” customers. While the issue for two is mainly labor productivity, for the other customer the issue is a shortage of qualified labor in the vicinity of their facility. Finally, several of the most “at-risk” customers characterize overall production expenses as their main concern.

The utility may want to offer assistance in their knowledge and/or purchase of new energy efficient equipment to their at-risk customers that are upgrading their technology and/or facility. In the area of labor, the utility may be able to offer customer assistance via seminars on increasing labor productivity. In addition, the utility may be able to link their customer with an organization that aids in recruiting workers for employers in search of employees. As for those customers concerned with their overall production costs, the utility can consider offering alternative procurement options, aiding trade ally programs and/or customer waste exchanges, offering technology assistance in the form of facility audits, and sponsoring customer seminars on increasing productivity and energy efficiency.

Obtaining Capital

Although all of the most “at-risk” customers have no major concerns with obtaining capital, many would be interested in a variety of investment options including shared savings and lease financing. The utility may want to consider offering customers these, and other, innovative financing options.

Expanding Markets

Half of the utility’s most “at-risk” customers are currently conducting or planning product, capacity, and/or facility expansions. The utility may want to consider offering operational analysis, technical and/or financial assistance, marketing support, or even discounted pricing structures to those “at-risk” customers going through expansion.

SUMMARY

All utilities will find some of their most important and valuable customers to be at-risk over the next several years. To maintain profitability, return to shareholders, and bring at least some stability to customer rates, all utilities will need to identify which of their customers fall into this category and develop a strategy to deal with and reduce the risk. Utilities not taking special efforts to track customer activities and designing special programs to better serve customer needs will find other electric suppliers more than ready to provide this service.

The CARE® program helps utilities prepare for the increasingly competitive marketplace by helping utilities identify their most “at-risk” customers with business needs that can be met by the utility, helping the customer gain a competitive advantage and helping the utility keep the revenue stream. By developing a business -- rather than an energy -- partnership, a utility can retain customers and establish a foundation for continued improvements in all aspects of their customers’ business.