

Brand Building in the Utilities Market

Contributed by Millward Brown
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The utilities market is changing across much of the globe. State-owned monopolies have been replaced by an array of companies selling gas, electricity and water. In this new world, where consumers are said to buy utilities on price and price alone and where utility company CEOs often argue that the best way to drive returns and shareholder price is to build scale, reduce costs and buy up other companies, many question the relevance of brand building. Here we contend that, as the number of utilities brands shakes down and consolidates, far from being irrelevant, brand identity will play an increasingly important role in determining future success in this sector.

In any market, brands play an important role for both consumers and investors. They help investors form a better picture of the ability of companies to grow. And they provide consumers with the convenient handles they need so that they can more easily make choices between what is on offer. But what role, if any, do they have to play in a commodity business like energy or water, and is branding utilities really worth it?

The big consumer switch

Research funded by the European Commission in 2007 found that:

- More than 85 percent of European consumers are reluctant to switch utility providers
- Of those that do, the vast majority are simply looking for a lower price – not exactly the brand loyal consumers most marketers want as customers

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But commoditization does not have to be a one-way street. The same research showed that most consumers do not mind paying a fair price for energy. Some, for instance, are perfectly willing to pay premium prices for “green” energy and so environmentally friendly brands have already started to emerge within the utilities market.

Because the market environment is rapidly changing, brand building in utilities is far more complex than in most other commoditized markets. When there are hundreds of similar-looking competitors, it is only natural for customers to look for the best price.

However, as the market consolidates, things will look very different. With only a handful of brands to choose from, brand identity will play an increasingly important role for consumers.

Uncertain future for investors

It will also play an increasingly important role for analysts and shareholders.

With value-building approaches limited to small market segments, and retail consumers generating only a fraction of most utility companies’ earnings before interest and taxes (EBIT), what counts most in building a rising share price is a strong brand.

Most financial analysts estimate a company’s value based on its previous performance. This works well when companies and markets are fairly predictable and sample data for comparable companies and sectors is available.

This is not the case for utilities markets where the current environment is unlikely to be a good predictor of the future. Yet deregulation and liberalization are political certainties in many parts of the world. And they will only accelerate the wave of consolidation we are beginning to see.

In five years, most utility companies will either have been bought up or look very different to how they look today. The winners of the consolidation process will not only be much larger in terms of revenues. They will also have higher margins.

This causes headaches for investors and financial analysts. If today we are only at the beginning of a long road towards consolidation, the value of most companies lies in the future – a very uncertain future, and one that depends crucially on the ability of boards to manage the growth process, pick attractive acquisition targets, or command the maximum price in the event of takeover. At the same time, those companies have very short track records. Consequently, investing in energy companies is much like a venture capital business, albeit on a multi-billion dollar scale.

Building a strong investor brand

Investors and analysts cannot predict such an uncertain future. But they can assess the ability of a company to grow – much like venture capitalists look at the management team and business idea of a start-up.

Building a strong brand can help investors better assess these capabilities.

Creating a unique brand identity

A strong investor brand can help a company stand out at the beginning of the consolidation process, providing investors with a more differentiated choice than – just another utility company that went public. A good investor brand not only creates value through investor relations and communications, it can also improve differentiation.

Take U.K. energy supplier Centrica, born in 1997 from the de-merger of British Gas, a former state-owned monopoly regarded as slow moving and parochial. Centrica was able to overcome negative perceptions of the British Gas brand in the financial markets through the launch of a completely separate brand. The resulting investor confidence has enabled it to obtain financing to expand into overseas markets. By changing its name from British Gas to Centrica, and through investment in the Centrica brand, it was able to move beyond – British – Gas not just in name but in geographical presence and scale.

Another U.K. company EDF which distributes electricity in London and East Anglia, uses a strong, unified investor brand on the stock exchanges, while operating a larger number of independent, often local brands, in various markets.

Differentiation as political capital

A strong, well-regarded brand can also help to make a company less of a target for policy makers.

For example, BP's re-branding positioned around renewable energy, has made it far more difficult to attack the company on environmental grounds. This is not only good for the company's image, it also reduces share price volatility and the risk of default which can help bring down the cost of capital. For the highly capital-intensive utilities industry, even a small reduction can increase shareholder value dramatically.

Growing popularity of dual-supply tariffs

Currently most energy companies are supplying customers with electricity and gas – either through partnership agreements or as full-scale integrated service providers. Although such dual-supply tariffs are becoming increasingly popular with consumers, it is those suppliers that have built a strong brand – which goes beyond a particular service – that are attracting the largest groups of new customers.

Take npower. This U.K. energy company increased its dual-purchase customer base by 33 percent in one year, following a targeted marketing campaign. Their annual report underlines that one of the key drivers of this improvement was a successful brand and marketing strategy.

In Germany, EnBW's subsidiary Yello Strom has successfully started an integrated offering – using a brand that is focused around a theme of energy, rather than a particular commodity like electricity or gas.

It is this extensibility that will make it possible for companies to tap into other related revenue streams. And they do not need to be energy related.

Brand extension – the big unknown

Some companies have already experimented with service extension into areas like water or fixed-line telephony services. But merely having the capabilities is not enough to ensure success. Consumers have to trust the brand. If they don't give the brand – permission – to supply other services, they will look at an integrated offer with scepticism.

However, a strong brand that goes beyond price and product is a real asset to brand extension.

Which means that investing in brand building now will yield dividends beyond the consolidation end game.

Energy supplies from non-energy companies

Given time and sufficient deregulation, non-energy companies will begin to enter the retail utilities market. Imagine what might happen should a brand like Orange or Virgin enter the electricity market positioning themselves around excellent customer service, feel-good and environmentally friendly energy and integrated “home connectivity” from power plug to broadband and beyond. Strong brands like these would be certain to find consumers willing to switch, in particular brand loyal consumers who are not price sensitive.

In mobile and fixed-line communications we are already seeing the emergence of “virtual” operators (notably Disney and ESPN) that do not need a physical infrastructure but only a licence.

Nobody knows yet if utilities markets will be opened up like this, but if they are, only a strong brand will be able to fend off powerful new entrants.

Is it worth it?

Brands have the power to generate financial impact both today and beyond. Investing in your brand is worth it, if it is done right.

Strong brands can:

- Attract new customers
- Differentiate a company from the competition
- Help facilitate brand extension
- Help investors better assess the ability of companies to grow
- Increase a company’s revenues and operating margins

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Although brand-building activity has been limited so far within utilities, expect far more of it as the market becomes more consolidated. And expect to see as winners those who best understand the role of “brand” in determining financial success.

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