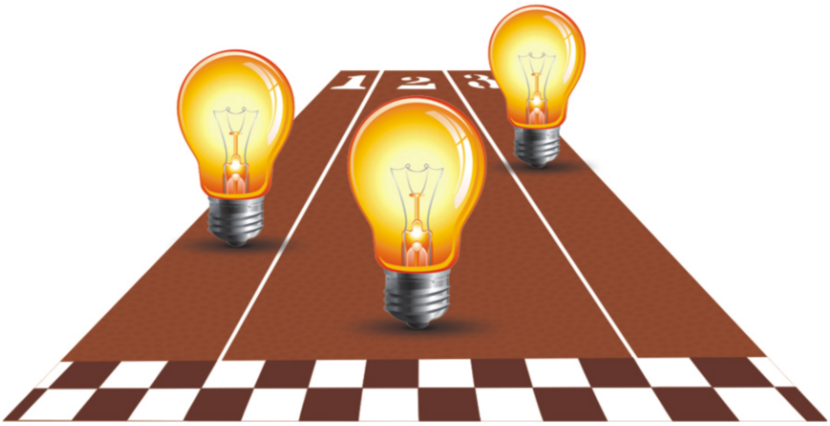

Helping Utilities Compete Better with Outsourcing

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Electricity deregulation and changes in the technology landscape have taken utilities companies on a route few had explored before. Companies are striving hard to gain competitive advantage. The shift from nationalized monopolies to de-regulated private enterprises and the adoption of new technologies like smart grid metering and alternative energy sources have brought in the need to re-look at the business focus and strategies that utilities have adopted so far.

The rapidly evolving industry that is expected to reach US $4.6 Trillion by 2015 globally, according to *Forbes India*, will have to overcome the myriad challenges it faces today to reach its potential. On the one hand, there is pressure on margins from higher fuel costs and price-cuts to gain over competition, and on the other hand, there is pressure on operations from increased political and social interventions due to environmental and security concerns. Earlier, utilities focused on the integration of ownership of functions like production, distribution and customer service. Things are changing rapidly. Utilities have now started focusing on singular aspects of business to gain competitive advantage and remain ahead in the fray. A May 2011 study by *HfS Research and ValueNotes* found that the energy and utilities industry is increasingly adopting outsourcing as a business strategy to achieve sharper focus on its core offering and entrust the delivery of quality customer service to an experienced player.

Tough Market Conditions for the Utilities Industry

The current global economic conditions have created difficulties for utilities to access finance. Poor economic conditions and ambiguities in project costs are discouraging investments, and investors are adopting a wait-and-watch approach. Moreover, uncertainty in project cost and the inability to pass the costs to the consumers have deterred investments. Many projects are bogged down by difficulties in implementation and execution. PricewaterhouseCoopers (PWC) recently identified 'significant shifts in the cost / accessibility of capital' as the top risk for power and utilities companies. PWC believes, "Power and utilities executives were more likely than those in any other sector to report continuing difficulty in accessing capital. This is likely attributable to the sheer scale of the investment needs in the sector."

New entrants into the sector face numerous barriers. The setting up of a new generation plant involves high fixed costs and a long and complicated process to obtain regulatory approval. Then, it takes significant time and money to win brand recognition and trust required to convince consumers to switch over. Once the power plant is built and a market established, the cost of serving one more customer or offering one more kilowatt-hour is minimal. But new entrants can only hope to realize similar unit costs by rapidly capturing a large market share. There is also a relative shortage of talented, experienced managers for which new entrants must compete. Nonetheless, the structural unbundling trend does offer entry opportunities, especially at the trading and retailing end of the market where upfront capital requirements are less burdensome.

Challenges for power utilities also come from the fact that the power systems supply business is dominated by a handful of companies. As the industry's vertical structures dissolve into a chain of generation suppliers, network suppliers, traders and retailers, profits will get distributed over more players, with each one's share shrinking.

Customer Demands, Pricing Pressure, Regulations – Adding to Woes

The balance of power is shifting towards the buyer. One company's electricity is no different from another; and service tends to be treated as a commodity. This translates into buyers seeking lower prices and better contract terms from energy providers. Commercial and industrial customers, in particular, enjoy leverage. As the industry becomes more competitive, customers will enjoy more power over their utility. The only differentiator that will work is superior customer service.

Power doesn't have a substitute and is a necessity in the modern world. Short-term demand for power is inelastic. This means that price hikes do little to diminish consumption. While there are no existing substitutes for electrons or natural gas, there are alternative ways to generate energy. Industrial groups have launched programs to develop small generators. Micro turbines and fuel cells are on the market horizon. These small generators could allow users to bypass traditional power grids altogether, or to limit the use of the grid when prices rise too much over time.

The industry has in fact been witnessing an interesting price war between utilities service providers for the past two-three years. In recent developments in the UK, *EDF Energy* announced a five percent reduction in gas prices, followed immediately by a similar cut from *British Gas* for its electricity prices. These reductions have come after gas and electricity price hikes last year that did not go down well with the British public. Now with the recent price cuts, the average annual domestic bill is expected to fall by £24. Analysts believe in their bid to outdo each other, rival utilities providers will eventually help bring down prices by 15-20 percent.

Government regulations are also putting additional pressure on a utility's profit margin. The recent introduction of the *Energy Consumer Protection Act* in Ontario, Canada has put additional burden on utilities companies. Utility service provider *Direct Energy* paid $1.5 Million as re-imbursement and waivers. Increasing taxes are also affecting a utility's profitability. It has been reported that a retail company makes just $500 per customer in five years through the supply of electricity. Utilities providers need some deep-rooted changes in business strategy to allow profitability without resorting to price hikes that could be detrimental in the current environment.

Focus on Increasing Efficiency

Utilities providers will have to explore different ways to increase revenues without hiking retail prices. Increasing operational efficiency can go a long way in this endeavor. Both supplier and retailer companies spend around 60 percent of their revenues as operating costs, out of which the cost towards human resources is the highest.

Utilities require better technology and continuous training of resources to enable higher efficiency. But with the current difficulties in accessing capital, such large-scale changes that require huge investments are difficult to implement. No fresh injection of capital means utilities will have to continue with manual back-office processes and inefficient customer service. Adding further concern is the paucity of skilled resources as a large section of the current workforce approaches retirement in the next 5-10 years.

Outsourcing is emerging as a strategic enabler for utilities companies as they strive to contain costs, bring in higher efficiency and enhance customer service. By outsourcing its back-office and customer care functions, a utilities company can avoid costly investments into technology and human resources. By leveraging the capabilities of a third-party outsourcing provider, utilities companies can deal with the current market situations on a stronger footing.

Outsourcing as a Strategic Enabler

According to HfS Research, the utilities industry in the US racked up $25 Billion in annual spend on outsourcing. Macroeconomic and industry-specific business challenges have had a direct impact on the level of outsourcing in the utilities industry. BPO partners are introducing industry-specific solutions, besides horizontal services such as human resources, training and procurement support, to meet the needs of clients in this space.

Demand is growing for IT solutions and research and analytics as global BPO service providers offer a complete suite of solutions. These solutions are tailored to meet the unique requirements of the industry and are offered through a global delivery model. The transition into Automatic Meter Reading (AMR) and the adoption of smart grid technology have brought in demand for systems integration solutions.

Outsourcing is helping companies to meet financial targets by achieving operational excellence. This is the result of streamlined processes, modernized infrastructure and a rationalized back-office. Outsourcing allows them to reduce operating expenses, focus managerial attention on the aspects of businesses that drive competitive differentiation, and access skills and capabilities not present in their organizations. Utilities have reported up to 30 percent reduction of the total cost of ownership due to outsourcing.

A majority of utilities players are working on "return to the basics" strategy. Utilities are increasingly focused on efforts to satisfy their customer base. They are focusing on the following four areas:

1. Reliability of service: Utilities are working towards improving their service level by adding new technologies, upgrading aging facilities, removing obstacles that lead to power outages (such as tree-trimming) and expanding capacity.

2. Customer contact centers: Utilities are trying to address customer queries in a timely and knowledgeable manner.

3. New products and services: Utilities are offering new products and services to increase customer satisfaction.

4. Stable prices: Even with fluctuation in fuel prices, utilities want to maintain a stable price.

According to an HfS study, *The Utilities Sourcing Landscape in 2011: Are Global Utilities Outsourcing Smarter?*, BPO services are now being offered at more competitive rates, giving way to smaller utilities also embracing outsourcing as a way to increase revenue. The two primary factors shaping the current E&U industry are an increased level in customer centricity and the adoption of new smart grid-related technology. Utilities are making the "outsourced customer services discovery", resulting in an unparalleled, two-fold benefit: Increased customer satisfaction and reduced overhead.

Additionally, outsourcing can ensure adequate investment in technology in non-core areas of a utility's business. In short, outsourcing can offer the same or better services at a lower cost, while reducing demands on the utility's capital budget. The benefits of outsourcing include the restoration of predictable growth, improved service levels and quality, and increased profitability for investors. There is now an increased willingness among utilities to align their outsourcing strategies to achieve the above objectives. They are re-assessing their own core competencies and re-evaluating their current outsourcing relationships not just for price, but also for the overall value the relationship offers.

To learn more, please write to us at **marketing@wns.com**