

# Energy in a Changing Environment

## Do “Big Dog” Strategies Always Work?

*Glenn S.K. Williams*  
*President & CEO*  
*EnergyChoice/NPC*

---

**There have been a number of innovative retail wheeling pilot programs offered by investor-owned utilities and their local regulators. These programs are providing retail consumers with energy options heretofore unavailable.**

**These offerings are just the beginning. The business environment in the energy business is rapidly changing with new entrants vying for their share of the new business. The question is what should be the strategies used by these new entrants and how should they be applied.**

**The answer can be found by examining the lessons learned from recent pilot projects, applying one of three generic strategies offered by Michael Porter,<sup>1,2,3</sup> and looking for the resultant opportunities. Each part of the answer is described below. In addition, advice for the energy engineer is provided and recommendations for the buyer are offered.**

---

### LESSONS LEARNED

In the northeastern portion of the United States there have been a number of electric retail pilot programs. In the midwest and Atlantic states there have been a number of gas retail pilot programs. In those programs there have been a number of interesting lessons learned. The first lesson has to do with the pilot programs themselves. The second lesson addresses “first-to-market” issues. The third analyzes the “big-dogs-eat-first” myth.

### **Pilot Program Issues**

The retail pilot programs implemented in New England and New York did not really simulate the energy market. They were concocted by utilities and their regulators to constrain the market and limit the utilities' future risk of stranded investment.

The pilot programs were designed to address only a thin segment of the utility's value chain. In most cases the pilots were constrained to the delivery of energy to limited market segments. There were only insufficient opportunities to offer other services and almost no possibility to segment the market. The effect of most pilot programs was to commoditize the energy part of the utility's value chain and attempt to limit competition in all other parts.

In retail pilot programs the utilities defined the product, the market place, and the market entry strategy. It was, for the most part, take it or leave it for the power marketing firms.

When the pilot programs are completed and full competition begins, power marketing firms will be able to segment the market based on a strategy that makes sense for each participant. They need not address the entire market and may select a segmentation strategy of only a portion of the market.

The lessons learned in this artificial environment are limited to the constraints placed on the pilot program. It is important to appreciate that these lessons do not necessarily reflect market reality. Observers (regulators, utilities, commentators, and consumers) should be very careful about forming premature conclusions and using those discoveries in designing future markets.

### **First-To-Market**

A number of power marketing firms believed there was value in being the first company to enter the new deregulated market. Many of them paid a heavy price for a position with questionable status.

One non-regulated subsidiary of an investor-owned utility company paid approximately 2.8¢ for wholesale power so they could sell it in a retail pilot program for 2.1¢. To add insult to injury, the resultant market for the pilot was much smaller than expected and represented the worst segment of the service area. This subsidiary obviously has a lot to learn about the free market conditions of the competitive market place—they cannot recover their losses from a captive rate base as their affiliates are accustomed to do.

It is not clear that anyone has gained from the push to be first-to-market. It seems that those who waited gained the most at the expense of the early entrants.

### **Big-Dogs-Eat-First**

Utilities like to say that big dogs eat first and other players are left with the scraps. As will be clearly illustrated later in this article, this theory does not always hold in a competitive market.

Pilot programs have taught us that big dogs are not necessarily smart. From the First-To-Market discussion above we can see that at least one big dog sold their power to their customers before they secured any cost effective supply.

Big dogs have shown us that large monopolistic organizations do not always exhibit the necessary flexibility required for the competitive market place. Decades of a monopolistic climate tend to make utility organizations cranky when they are thrust into the competitive environment.

Many big dogs have inherited a burdensome cost structure from their monopolistic cousins. Those heavy cost structures make it hard for the big dog to be a cost leader in a broad market.

The telecommunications and energy industries have already taught us that many of big dogs don't always live very long. Enron, AES, MCI, and Sprint are all recent examples of little dogs that have become bigger dogs. Stone & Webster, United Engineers, Ebasco, and Bechtel Power are all recent examples of retiring old dogs. Northeast Utilities, Central Maine Power, Commonwealth Edison and Long Island Lighting are all current examples of very sick big dogs.

## **THREE STRATEGIES, FOUR POSITIONS**

There are three sustainable strategies that a power marketing company or energy aggregator can take: cost leadership, differentiation, or focus.<sup>1</sup> The four positions are the same as the three strategies except that the fourth and additional position is situation of "being stuck in the middle" of the three strategies.

### **Cost Leadership**

Cost leadership is a broad market position where the power marketer has a low cost structure relative to its competitors. This is

		Competitive Advantage	
		Lower Cost	Differentiation
Competitive Scope	Broad Target	Cost Leadership	Differentiation
	Narrow Target	Cost Focus	Differentiation Focus

**Figure 1. Three Strategies**

achieved without the company jeopardizing its quality or service.

Monopolies and other big dogs should note that the cost leadership position is not the same as price leadership. Having low prices and high costs is not a sustainable position (see First-To-Market).

Cost leadership requires an industry-wide commitment. It means vigorous pursuit of cost reductions and efficient scale facilities. Cost leadership requires tight cost and overhead control and avoidance of marginal customer accounts.

Cost leadership means minimization of R&D, service and marketing expenses. It implies high market share and favorable access to energy sources. Cost leadership may require heavy up front capital investment and start-up losses.

The benefits of cost leadership are sustainable revenues and control over the market. The result is long term profits.

The risk is that there can only be one cost leader; all other contenders will be bloodied in losses. The other risk is that it is difficult for the cost leader to adjust to changing markets. The difficulty is exacerbated by the heavy capital investment in the market position.

### **Differentiation**

Differentiation is a broad market position where the power marketer provides uniqueness relative to its competitors. This position is achieved when the buyer perceives that the seller's differentiated service is important and valuable.

Differentiation requires an industry-wide commitment. The company must develop a perception that its product has value, exclusivity, or difference. Its value is perceived to exceed the cost of differentiation. Differentiation requires cost proximity to the cost leader.

The benefits of differentiation are sustainable revenues and margin without being the cost leader. The result is more margin than the cost leader (but less revenue).

The risk is that the differentiator cannot gain high market share. The other risk is that buyer perceives a uniqueness that is not valuable, there is too much differentiation, or too much premium.

### **Focus**

Focus is a narrow market position where the power marketer achieves differentiation, lower cost, or both relative to its competitors. The seller is rewarded for its focus with a premium price.

Focus requires serving a particular target very well. Companies within the focus strategy must have the ability to be more effective or efficient.

The limitation of focus suggest that the seller cannot compete more broadly. In addition the seller is in a constant position of trading off between profitability and sales volume.

The risk is that the buyer perceives any uniqueness as not valuable. The buyer may also perceive that there is too much differentiation or there is too much premium.

Another risk is that competitors find submarkets. The result is that the focuser is out-focused.

### **Stuck In The Middle**

If a company is not either a cost leader, differentiator, or focuser; it might be stuck in the middle of the three.<sup>2</sup> This position is almost guaranteed to provide low profitability and it will take considerable time to extricate the firm from this situation.

There is a tendency for such firms to flip back and forth between strategies. This will likely doom the firm to failure.

## **OPPORTUNITIES**

Looking at the strategic tool and the lessons learned from the pilot programs, we see that, if we look at Porter's model, a number of big dogs appear to be making some very strategic mistakes.

Power marketers should let the big dogs and other fools fight out the cost leadership slot. Let them take the broader market. Let them take the "first-to-market" position. There can be only one winner and

the others will be badly bloodied (and distracted).

In the energy markets there is plenty of room for differentiation and focus. At over \$300 billion per year, the electricity business is one of the largest industries in the free world.

The strategy for power marketing firms is to get into the customer's value chain *and* into the utility's value chain.<sup>3</sup> The business is not limited to the provision of simply energy; there are a number of other options. Those options include meter reading, invoicing, and service.

## CONCLUSIONS

The industry has a lot more to learn. Pilot programs were just the beginning, not the end of learning. There are three strategies to consider and, for most power marketers, only two options that make any sense. Differentiation and focus will provide many opportunities for everyone.

Do not get caught up in the big dog mentality. It is simply a mind game provided by the herd stampeding toward the single cost leadership position.

History has demonstrated that there are wonderful opportunities for smaller and niche firms. It also has provided a number of opportunities for lesser known firms.

**If you are a purchaser of energy, understand the strategic position of your providers. Understand that cost leadership may not necessarily mean price leadership nor may it imply adequate service and quality. Differentiators and focus companies may provide your organization with more custom services at a better net price.**

## References

- 1 Michael E. Porter. *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. The Free Press, New York, New York (Pp. 34-46), 1980.
- 2 Michael E. Porter. *Competitive Advantage: Creating and Sustaining Superior Performance*. The Free Press, New York, New York (Page 16), 1985.
- 3 Michael E. Porter. *Competitive Advantage: Creating and Sustaining Superior Performance*. The Free Press, New York, New York (Page 36), 1985.

---

## ABOUT THE AUTHOR

**Glenn S.K. Williams** is President and CEO of EnergyChoice/NPC and brings to his firm approximately 25 years of relevant energy experience in leading, managing, and organizing energy programs. Mr. Williams has been CEO of three separate energy organizations and a senior officer of five private sector energy firms. Earlier, he was a management counselor to NYSE-listed corporations including the chairman of the board of Public Service Indiana, the chairman of the board of Duquesne Light, the vice-chairman of the board of Consumers Power, the chairman of the board of Stone & Webster, Inc., board director and chief executive officer of Stone & Webster Engineering, and other energy industry organizations.

As part of his work involving deregulated and independent energy programs, he formed one of the nation's first power marketing companies (National Power Management Company), has worked with investment banking institutions to capitalize and manage a merger with a competing power marketing firm, and has managed third-round financing with large investment banking organizations, financial institutions, and investor-owned utilities. He has integrated his firm into the industry with memberships in regional power pools, associations, and relevant state working groups.