

# A New Wave in the Energy Market

*“Change is the law of life. And those who look only to the past or present are certain to miss the future.”*

*John Fitzgerald Kennedy, 1917-1963*

To succeed in today's fiercely competitive world of business, classical market segmentation characterized by demographic, socioeconomic and geographic criteria won't cut it any more. A powerful new tool to forge a cutting edge is segmentation based on psychographic criteria, as demonstrated in Germany's energy market.

The German energy sector is characterized by an attempt at liberalization, that after ten years has created a fragmented scene of multiple small companies and four looming giants. In their struggle to distinguish themselves from the competition, some of the companies have adopted innovative customer segmentation techniques – cutting-edge marketing strategies based on defining customer groups by signs and lifestyle types. The following describes a range of psychographical market segmentation techniques, followed by their implementation in the energy sector.

## **Changing business conditions**

Social and technological

changes have been challenging the way business is done. In the past, the consumer wielded little influence over product characteristics and variety.

This is changing. We are in an era of individual consumer empowerment, which is even influencing product development processes.

cent data implies a strong individualization, and rapid changes in how the consumer acts. Unsaturated markets turned into mature markets with exchangeable products in which added value and target-group aligned campaigns become increasingly important. Companies today acknowledge that not every



Once, cultural values and consumer behavior were relatively predictable. Re-

offer will suit every customer, nor will every customer be equally responsive to a given

# German

By Angelika Gruber

marketing activity.

Not only is the nature of the market changing: by nature businesses, however successful, are also vulnerable to change in the general economic environment, including demographic change, urbanization (where applicable), individualization and fragmented global societies. The way to remain relevant in this rapidly changing world is to track who the customers are, what their needs and values are, and where future potential lies in a world in which individuals have very different requirements. Each individual becomes a segment of its own in a global market.

For example, the so - called “hybrid customer” buys basic groceries at a discount outlet, but eats the weekend luxury dinner at a five-star restaurant. It is important to understand that price is not always the key purchase criterion. It is a poor understanding of the actual desires of customers that leads suppliers to focus on price competition.

## **The need for new market segmentation models**

The ultimate objective of an efficient segmentation model is to enhance profitability by recognizing that each identified

customer group has different needs, priorities, and economic levers. Armed with that knowledge, customer service can be adapted and resource allocation can be optimized. The ultimate goal of segmentation is the pragmatism of superior deployment: how best to utilize corporate performance capabilities to meet the needs and expectations of the customer population.

The final outcome of segmentation for the customer is superior satisfaction. Companies for their part expect the market segmentation model to deliver clearly defined groups of customers, unique customer insights, and market insight concerning future opportunities and innovations.

Traditional segment classification focuses on statistical characteristics such as geography (city, region, size of place of residence), demographics (age, gender, nationality, income, family status, size of household), and so forth. This approach is convenient because the data is usually easy to collect, and is clear-cut and objective. But it fails to take into account that customers do not behave consistently within these defined clusters.

Also, because new markets are difficult to locate, it is necessary to actively cultivate the

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Ozzy Osbourne

- | Segmentation criteria |                      |
|-----------------------|----------------------|
| ✓                     | Fifty plus years old |
| ✓                     | Male                 |
| ✓                     | Two adult children   |
| ✓                     | High income          |
| ✓                     | Real estate owner    |



Prince Charles



market and explain or model customer behavior. Traditional sociodemographic criteria are not capable of describing the (potential) customer of today. For instance the same data set of “gender-age-income-habitation” would apply equally to Ozzy Osbourne and to Prince Charles.

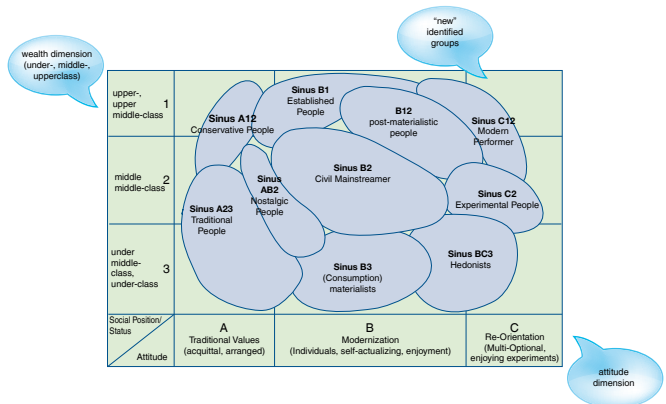
### Examples of innovative segmentation models

To fulfill future segmentation requirements, psychographic and behavior-based models become significant. Characteristics such as lifestyle, values, social standing, media usage, buying patterns, brand preference, product usage pattern, and the like can be used to describe customer groups. One example for a state-of-the-art segmentation model is the Sinus-Milieus® approach, which clusters homogeneous groups by shared aspirations in life, value systems and lifestyles. When individuals share similar life contexts, they are likely to be part of the same milieu. The model distinguishes several milieus and builds a quantitative

conclusion through a representative sample of the given population. Another example of an innovative segmentation approach is semiometrie™, a quantitative tool to distinguish groups by values and attitudes. This methodology is based on evaluating 210 selected words such as hero, victim, present, and fire on a seven-stage range, from “very agreeable” to “very disagreeable”, to quantify the person’s values. The four dimensions of the “words/value map” are sociality, vitality, individuality and

responsibility. The identified customer cluster is characterized by 14 value fields, such as familial, social, religious, rational or dominant. The data are then statistically evaluated for the specific product, service or brand. Another psychographic model, developed by the international market research company GfK Group, is called Euro-Socio-Styles. Its Value Map is based on four dimensions: appearance and reality, change and stability. Arranged behind these four dimensions are different needs: appearance implies materialism and price orientation, reality stands for quality orientation, change for dynamic, and stability for security. GfK identified eight Euro-Socio-Styles®: magic world, secure world, steady world, standing world, authentic world, new world, cosy tech world and crafty world. Each segment is described with typical attributes, attitudes and

### Sinus-Milieu Map



habits.

Consumer market-based segmentation models can also apply to the broader business market, using different selected attributes such as value perception, position in the value chain, buying behavior, its own value proposition downstream and so forth.

### **Building up consumer insight**

Developing a trend-setting segmentation model for a specific market generally starts with defining the relevant group of customers (consumer/business), understanding the structure of the entire value chain (also downstream) and identifying value levers and decision makers along this chain.

The second step is to discern the attributes describing the group in terms of buying criteria – identifying the needs behind their purchasing. This can be conducted through market research, expert interviews, customer surveys and multifunctional customer workshops in B2B environments.

The third step is to create different clusters with comparable attributes and buying criteria and qualify them in terms of sufficient size, differentiation between the groups, and feasibility on the part of the business.

Finally, the identified market segments are summarized as profiles and are given a descriptive name. The profiles describe the distinctive at-

tributes, main buying criteria, values, sociodemographics and other characteristics of each group. For each of the groups which seems attractive, an individual value proposition needs to be developed. These psychographic segmentation methods give enterprises powerful tools to improve profitability through differentiation, positioning and a focused and tailored communication towards the relevant target group. They were applied to great effect in Germany's energy sector, as it transformed from a blanket monopoly into a liberalized market.

### **The German energy market before liberalization ...**

The trend towards freedom of choice for the customer is spreading in both the industrial and private sector. In Western Europe the process of liberalization aimed to set the entire energy market free. The results have been mixed. The pace at which the different countries within the European Union are liberalizing their energy market differs from one nation to another. Some countries, such as Germany and the United Kingdom, have completely liberalized their energy sphere while others, such as France, are more tentative.

Before liberalization, a defined supply area was served by a single energy supplier, usually a local utility, resulting in a monopolistic market structure.

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Ten years ago, "Grid access for everybody" was a vision. Now it's the reality, if not quite the reality that its engineers envisioned.

The European Union Directive of December 1998 eliminated guaranteed territorial monopolies, resulting in new, oligopolistic energy markets. The EU aimed to minimize political intervention and intensify competition into grid access and energy distribution (electricity and gas) by letting in new suppliers, and lowering prices for consumers. In Germany, energy production, transportation, and distribution were unbundled, to deliver a transparent as well as efficient and well-priced energy supply.

### ... and its implications ten years after

It failed. The "steps to boost competition" resulted in anti-competitive concentration. Ten years after the liberalization drive began, the German consumer is paying more than ever before for electricity. Moreover, ten years after the reform, instead of true liberalization and competition over price, 80% of Germany's market remains dominated by four big companies: E.ON, RWE, EnBW and Vattenfall. About eight hundred public utilities and municipal energy providers, some belonging to the giant four, utilize access to the grids of the big companies to develop and spread their business and products into new regional geographic areas, which had not been

possible before liberalization. Germany's energy market harbors risks for the energy producers and suppliers such as regulator-induced reduction of energy consumption and other changes, feeble market growth, high prices, and internationalization and consolidation of the market. But it also offers opportunities such as the trend towards online marketing, changes in the energy production technologies (decentralized energy supply, renewable energy), branding, and a rising (though still low) tendency among customers to switch the energy supplier. The questions for the new energy suppliers are how to win consumers and lock in long-term success. The answer many found lay in psychographic models to identify differentiation opportunities, at long last addressing the customer.

When the era of liberalization began, its architects assumed that customers would switch in droves as competition arose. They did not: or at least industrial clients do, but not households. Only 7% of these have changed provider. Private-sectors tend to stay with their vendors mainly because of sheer passivity, assumed high switching costs, and various barriers including ignorance of alternatives. Within the industrial segment, 37% did demand changes to their contract with their supplier. Price remained the most important criterion for change. However, this switching rate is

lower than what surveys show to be the switching intention of such customers.

### Challenging market conditions

In the years to come, switching is likely to increase as competition intensifies, in part due to persistent political efforts and changing consumer patterns in energy use. Consumer sensitivity to price is also likely to intensify. Other



impetuses to switch may include subjectivities such as perception of bad service or the wish for "ecological" energy. Customers will stay with their current provider when either they are satisfied, don't know a better alternative or are not even considering change due to lack of interest. Today's energy providers in Germany can be allocated to three clusters:

**1. Consolidated companies and utilities** with an "all-round" mainstream strategy, a

mix of representative products across all production sources, targeting for the middle price segment on a regional basis with a low customer attention and low level services.

**2. Ecological Specialists** that adopted a “green” communication strategy in a high-price segment with high customer satisfaction, advanced services and a nationwide presence

**3. Online providers** with a discount and brand strategy,



zero or a low share of “green” products, tailored online services to ensure reasonable customer satisfaction in a low price target segment.

All three clusters seem to target distinct market segments and customer groups, but they have learned in the last few years that retaining customers is cheaper than acquiring new ones. Yet many companies tend not to fulfill the potential value of their relationships with their existing customers: they remain focused on win-

ning new customers, spending heavily on marketing while losing sight of the existing base. They neglect to analyze and leverage customer relationships to exploit additional potential and product opportunities.

The “big four” still live off their competitive advantage due to their vertical integration (production, grid and distribution) and are less vulnerable to market dynamics in the short term. Smaller companies and “newcomers” face higher challenges in getting a reasonable economic model to work. But they are coming up with answers.

### **Innovative techniques in Germany’s energy market**

Energy experts have found that more than half of Germany’s energy providers have started to invest in innovative marketing and sales campaigns. They are employing advanced marketing concepts such as product bundling in cooperation with loan institutes, insurance, and real estate companies based on cutting-edge psychographics and a broader view of customer needs.

In short, these companies plan to conquer niches using customer-orientated innovations. Objective classical segmentation criteria such as energy consumption, demand set and solvency cannot provide meaningful clusters to evaluate customer needs and to develop the right value

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proposition and value delivery system for their market strategy. Energy companies still need to distinguish within their segmentation approach between the two main traditional user groups of industrial customers (B2B) and private customers (B2C). For both groups the companies have to define the relevant attributes which influence switching behavior. Within the German market the following seven descriptive characteristics have emerged and have proven to be a valid set of criteria:

- Price sensitivity
  - Desired level of services
  - Brand consciousness
  - Value orientation
  - Affinity to innovation
  - Willingness to take risks
  - Tradition consciousness
- Having analyzed the degree of the various attributes for the respective customer groups, eight different customer segments can be derived. Within the B2C group for ex-

ample, so-called "Piggybacks" can be identified. They are characterized by strong brand consciousness and intense safety needs, whereas so-called "Rationalists" focus on smart shopping and conscious consumption. "Traditionalists" are reacting against "globalization": they demand local values and traditions in a globalized world and a high degree of social responsibility. The "Impulse Buyer" is an enthusiastic and interested shopper in contrast to a "Self Actualizer" who is seeking individuality and quality. Within the B2B group three segments can be distinguished. The so called segment of the "Neglected Buyers", the "Added-Value Oriented Buyers" and the "Price Buyers". The "Neglected Buyers" seek individuality, risk reduction and comfort, whereas the "Added-Value-Oriented Buyers" focus on smart shopping combined

with a high demand for service. The "Price Buyers" can be compared to the "Rationalists" in the B2C group: these companies are becoming more price conscious as they perceive the development of an increasing price volatility in the market.

As described, each segment is marked by strong characteristics. The more distinctive these unique features are, the more focused market development can be.

Having segmented the market, the energy providers must now prioritize them - choosing the most attractive segments that offer attractive profitability at reasonable market risk, and decide which products and services to offer to each chosen segment at what price level. The companies need to position themselves with a "new", innovative value proposition and communicate their "unique selling point" (USP) accordingly and sustainably. Companies that adopted a psychographic analytical approach are showing initial success in retention rates and in developing new market shares. This proves that in today's fast-moving society, innovative and traditional B2B companies in "pure commodity and low interest" markets can apply psychographic-driven segmentation to reshape their market positioning and to generate competitive differentiation and advantage.

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