

# **CHARTERED INSTITUTE OF MARKETING**

## **ANALYSIS AND DECISION**

CASE STUDY

JUNE 2004

# **Centrica**

Quantitative and qualitative  
Analysis

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## CANDIDATE'S BRIEF

As a Marketing Consultant to the Board of Centrica you will be expected to advise the board of Strategic Marketing decisions, both qualitative and quantitative.

The Board will want to know answers to the following questions:

How much will it cost?

What is the expected ROI?

How much profit will the strategy drive?

What marketing strategy should be adopted?

Key themes- international, opportunities, customer relations (CRM)

Energy market – complex and global.

U.K. based but designs to expand in to Europe and North America.

Developing trust, business ethics both important cf. Enron.

Acquisitive company – AA, Goldfish, since divested. What is their rationale/criteria for purchase?

Not always successful acquisitions but at least they are willing to admit defeat and divest.

Competitive global arena – U.K, European and American competition.

Market capitalisation – weak.

Outdated image, old British Gas image.

Branding is a challenge .Different brand names currently used in different markets.

Challenge is to develop a market focus for the next decade.

Have to work at Board level – strategic decision making process and all strategies have to be cost beneficial.

## **Centrica PLC**

### Introduction

Key points-Centrica formed in 1997, following demerger of British Gas Plc. Created opportunities but initially group comprised of gas supply, services and retail businesses of British gas, selling white goods, and gas production (North and South Morecambe gas fields).Also retained Goldfish credit card brand.

Accord Energy – JV between British Gas and NGC Corporation of Houston, USA.

Centrica became able to buy and sell gas on the open market.1998 – consumers were able to receive their electricity from British Gas. Centrica also made its first upstream purchase – buying PowerGen's gas and oil company, PowerGen North Sea Ltd.for £248million.

1999 – competition for domestic and business electricity customers intensified and 1.5 million customers chose British Gas as their electricity supplier.

BG closed its 243 British Gas Energy centres as a result of difficult High Street trading conditions.

### **Acquisitions**

In 1999, Centrica acquired the AA – gave company a foothold in the car insurance and distress rescue market.2000 – Centrica formed JV with Vodafone. In the next two years Centrica

continued to create strategic alliances and acquire energy and service companies, and purchase customer bases in the USA and Canada.

Figure 1 represents Centrica's growth path.

### **Company values**

Figure 4 encapsulates the company's values.

### **Company Performance**

Figure 5 shows some positive signs – Market capitalisation of £10 billion. Steady growth year on year. ROCE – 32%

Profit by business area.

### **What is Centrica?**

Customer hub – domestic gas customer base forms the core and allows the company to cross sell other services, such as AA, insurance, electricity, etc. as in list a-h on page 8

Figure 6

Telecom services is the star performer (0.15m-1.2m) and residential electricity is also doing well (3.9m – 5.8m)

### **British Gas**

May 1999 – brand audit carried out. Customers felt that British Gas would become better and that customers would benefit accordingly. Customers are now more willing to accept utility suppliers from one 'meta-supplier'. This leaves British Gas in a good position.

Figure 7 (page 10)

Key brand values/brand essence. Contradictory in many ways.

Figure 8 (page 11)

### **Consumer perceptions of change in British Gas**

There is some opportunity for British Gas to brand itself differently. **Question area.**

Consumer acceptability on page 11 is a very useful list of needs and wants of consumers.

Figure 9

Consumer perceptions of changes in British Gas.

Figure 10

Purchasing behaviour of consumers vis a vis gas and electricity.

British Gas has made significant strides in the provision of electricity.

**Question** – How can they sell more electricity to consumers?

Centrica is a global brand whereas British Gas is a national brand.

One Tel and British Gas telecommunications (page 15)

2 brands offering telecommunications

1. – British Gas Telecommunications – 400,000 ‘active customers’ – most have an existing relationship with British Gas.

2. – One- Tel – 800,000 ‘active customers’ has 18 % of residential international call minutes. Company tends to attract younger ‘sophisticated’ telecommunications users, with 30% serving through the Virtual Customer Service Centre.

One Tel was set up when the BT monopoly was opened up by the UK Government. One Tel is a serious contender within the telecommunications market but is not necessarily really well known. **This represents an opportunity for Centrica.**

Figs 11-13 demonstrate the level of awareness that consumers have of One Tel which is overall 40% of adults.

**Question** – How do One Tel raise awareness even further and get people to switch?

The market has changed considerably in the U.K and deregulation has led to a massive influx of alternative competitive activity. The market is estimated at 1 trillion U.S. dollars. B.T. dominates the market **BUT** their market share is gradually being eroded by players such as One Tel.

**Question** – How can One Tel gain a greater share of this lucrative market?

Does the affiliation with British Gas via the Centrica brand give any advantage? E.g. trusted source, safe, reliable, probity.

### **Broadband**

Residential market will be worth \$88 billion by 2007 = sevenfold increase in next 3 years (Huge growth area = opportunity for One Tel (Centrica) )

Competition will be intense – complexity will increase therefore Centrica need to employ the most technically gifted people or buy out smaller, more entrepreneurial companies.

### **AA**

Brand proposition – figure 14 (page 16)

Not just roadside services/breakdown but also customer relationship strategies, using databases to offer insurance and financial services, playing on the reputation for probity and reassurance.

### **Goldfish**

Brand values – Fig 15

Perceived newness and affiliation with British Gas helped to reach a wider audience. As a newcomer, it has some advantages. Goldfish – associated with youth and fun. Did it fit? No, because Centrica sold it for £112.5 million. This shows that the company is prepared to divest as

well as acquire to release cash funds.

(See Appendix 4 – re branding as a value to balance sheet)

How do you calculate Centrica's brand value?

CENTRICA BRANDS (Portfolio)

(U.K)                      BRITISH GAS/              AA/                      ONE TEL

(International)              DIRECT ENERGY      (CANADA)  
ENERGY AMERICA      (U.S.A.)  
LUMINUS                      (BELGIUM)

### **International companies**

Centrica has a foothold in several international markets, such as

CANADA/USA/BELGIUM/SPAIN/HOLLAND

Direct Energy (Canada)	Energy America Greensource Enbridge (U.S.A)	Luminus (Belgium, Spain, Holland)
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### **CORPORATE SOCIAL RESPONSIBILITY (CSR)**

Centrica places a great deal of emphasis on helping with the community, environmental protection, sustainability, charitable donations, and employee welfare.

Examples include British Gas/ Help the Aged partnership (Stepping Out event – pages 52-54)

### **Branding relationships**

Branding = trust and confidence. Trust breeds loyalty. It is 6 times cheaper to retain than to acquire customers. Centrica – relatively new brand name. AA and British Gas are well established brand names. One Tel is a new brand name.

The CRM programme is expensive at £450 million. Has it delivered value for money yet?

(Figure 16 – Developing a decentralised customer hub)

This type of strategy also requires customer permission and 'buy in'. How important is the Centrica brand, as opposed to individual brands such as British Gas, AA and One Tel ? (cf the former Kingfisher – B&Q, Comet, Superdrug, Woolworths)

Customers are fickle and often resist attempts at cross selling, via telephone, direct mail or email campaigns.

Non household gas and electricity markets are due to open in 2004, equating to 60 -70% of the market by volume. (This is an opportunity and also a threat for Centrica)

Centrica is not as big as some of its competitors and as a global player it may need to operate under a single brand identity which is easily recognisable (cf. Sony, Coca Cola).

A CRM is difficult to get right because of unpredictability and rapid change. It can work if you operate in a stable market environment because it assumes that :-

- Customers will repeat their past behaviour in the future
- Market conditions will not change significantly

In a dynamic, fast changing market environment this is very difficult. Range of competitors – customers' perceptions will change fast – brand promiscuity occurs.

So, DEVELOPING A VALUED BRAND IS A MUST.

If trusted, a customer is likely to become loyal and customer lifetime value becomes increasingly relevant and important.

Figure 17 – Customer lifetime value

Too many companies, having secured a customer's order, then turn their attention to seeking new customers without understanding the importance of maintaining and enhancing the relationships with their existing customers.

Ladder of loyalty (Payne and Christopher)

Advocates are absolutely vital to the success of any company.

Referrals from customers are among the most relevant, effective and believable sources of information for other customers (Refer to 'Relationship Marketing – Creating Stakeholder Value – Christopher, Payne and Ballantyne, pages 48 -63)

### **Summary**

What is Centrica's raison d'être?

European market – poised for expansion.

Global market – only has partial exposure (N.America/Canada) but it is starting to pay dividends.

Global arena – further expansion possible and necessary.

### **Question**

How can Centrica consolidate its U.K. market effectively, and at the same time expand its presence in international markets?

The company has to reassure shareholders that it can manage a complex portfolio and post good profits.

The case claims that the company has an effective marketing structure but there is no evidence in the case to substantiate this.

### **British Gas (Operating and Financial Review)**

Page 30 – Profitability up in 2002.

Reference to CRM – to enable improved service levels, a lower cost to serve, and lower costs to acquire new product relationships.

£25m investment in CRM 2002

£9m investment in CRM 2001

### **Residential Gas**

Turnover decreased by 6% in 2000 but gross margins recovered to 20% (up from 12% in 2001) driven by increase in average selling prices and a reduction in transportation and metering costs. (they now use estimates rather than send out meter readers to houses which is very expensive).

Withdrew from LPG business because they wanted to focus on direct customer relationships and a huge portion of LPG business was operated via 3<sup>rd</sup> party retailers, therefore no added value.

## **Residential Electricity**

Turnover increased by 23%! Very good performance. Now have 22% market share. Gross margin fell 1% to 26% due to increased transportation and metering costs.

## **Home Services**

Turnover improved by 12% to £810m. Home electrical care represents good growth area (up 157%).

69% growth in operating profit – increased both customer numbers and product penetration. British Gas is investing in the training of engineers to meet future demand.

## **British Gas Communication**

Turnover up by 41% in 2002 at £52m (2001 - £37m) due to higher average number of customers. Operating loss - £35m, down from £101m in 2001.

Centrica need to get this right this year as losses are unsustainable. Should they divest or drive on?

## **Centrica Business Services**

Supplier of energy to the commercial sector. Centrica has 51% of the gas market and 20% of the electricity market.(commercial energy).

## **CEMG (Centrica Energy Management Board)**

Operating profit = £72m in 2002 as opposed to £5m in 2001

## **AA**

Ongoing investment in brand positioning launched in May 2002. Increased consumer awareness of product portfolio from 33% to 43%.

Turnover grew by 10% to £760m. Operating profit increased 1.4% to £73m . Repositioning of the brand will support the cross selling of the whole product range. Also AA is investing in a major CRM infrastructure programme over 3 years. AA's web site won an award for e-business strategy of the year.

## **AA Roadside Services**

Turnover increased by 5% to £476m (membership growth). Operating profits increased by 28% to £54m.

## **AA Personal Finance**

Turnover grew by 11% to £172m 'car loans for car people; (personal loans) Personal rates on motor/home policies rose from 74% (2001) to 78% (2002).

## **Other AA Services**

Halfords garages – rebranded to AA Service Centres.

Tyresave – fixed and mobile tyre services – 3,000 strong network.

## One Tel

£2m spent on a marketing campaign to raise awareness of One Tel's transition from a discounted international calls provider to a full communication provider offering landline, mobile and narrow and broadband internet services. First call inclusive package launched. Migration to a single billing system in 2003.

## Goldfish

It was loss making and did not fit.

## Centrica North America

Total N. American turnover = £1,118m in 2002, increase of 46% over 2001, driven mainly by entry into Ontario and Texas electricity markets and acquisition of 300,000 gas customers via acquisitions of Enbridge Services and parts of NewPower Company's customer base.

### Risks of international marketing

Forward contract prices expired.

Currency fluctuations lost the company £4m .

6% decline in the average Canadian dollar exchange rates during the year

## Retail Energy

Turnover for residential gas supply business increased by 12% driven by higher selling prices and acquisitions. Ontario residential gas market share was 26% at year end. U.S gas markets – high customer churn rates (brand promiscuity) caused slower growth – offset by acquisition in August of 212,000 customers in Michigan, Ohio and Pennsylvania from the NewPower company.

Current strategy – maximising value.

Third largest electricity retailer in Texas. The challenge lies in accurately forecasting total commodity requirements,(purchasing it at a fixed forward cost),customer acquisition and retention.

Turnover – £189m operating loss still £10m, down from £15m loss in 2001 (going in the right direction).

High wholesale spot prices, acquisition costs and churn rates are eating into profitability.

High levels of churn caused mainly by volatility in forward spot market so customers had signed up to relatively high prices for gas supply. So naturally customers change to a cheaper option when they become available via competitors.

Retail Energy has 15% of the residential electricity market in Ontario and 26% of the residential gas market.

New legislation passed by Ontario government means that further organic electricity growth is not possible until 2006.Potential problem for Centrica – government subsidies – protectionism – inhibits free trade. Problem for Centrica – inhibits growth and the ability to cross sell other services/utilities. (although they can still do this with their existing 500,000 customer database).

Question – Will this protectionism have an adverse effect on Centrica's performance?

Acquisition strategy – Centrica looking to acquire ATCO group in Alberta( consists of 820,000 gas and 160,000 electricity customers – this will give Centrica a 80% share of the gas market and a 14% share of the electricity market).

Growth in 2003 will come from migrating customers to unregulated energy and services packages.

Yes, but what if energy becomes totally regulated? Centrica will be exposed and protectionism will erode their profit margins, forcing them perhaps to divest or operate at a loss!

#### Home and business services

Acquisition of Enbridge services (May 2002) – part of Centrica’s strategy to gain competitive advantage and operating leverage for energy and home services cross selling platform  
Cost of acquisition – £438 million . Made £23 million profit during the year. Centrica sold most of the water heater business of Enbridge (58%) – unbundling, which raised £303m . The remaining 42% will be sold off at a later date. Centrica however remains the exclusive installer and provider of maintenance and repair services for the country’s water heaters. So they have a relationship with approximately 1.3m households so they can cross sell. Sound strategy of unbundling, divesting and retaining profitable parts of the business to build customer relationships for future sales and cross selling opportunities. SMART MOVE ! – This has created major shareholder value.

Centrica also remain a leading installer of heating/ventilation/ and air conditioning (HVAC) equipment in Ontario.

Hold 50% share of home services market – increasing this market share is a key objective for 2003.(Business customers will be managed separately)

Gas	Electricity	Home Services
	Domestic	Business

#### Upstream Gas

Development of gas fields in Alberta continues but operating profit fell by 47% as a result of a lower wholesale market (volatile) – led to a 23% decline in average sales price and expiry of higher priced forward sales contracts.(Volatility of forward spot market makes future planning very difficult).

#### Europe

More advanced economies – better for unbundling, deal making etc. Through Luminus (Belgium) Centrica has 18% of the electricity market. Luminus is number two in the Flemish market. Centrica expect to have 600,000 residential electrical customers and 200,000 residential gas customers (opportunity for expansion).

In Spain, Centrica is looking for organic growth in the SME sector using skills developed in other markets. Operating loss in 2002 was £7m reflecting start up costs in Belgium and Spain.(language and cultural issues?)

#### Group Financial Review

Although the statement from financial director Philip Bentley is upbeat, performance is not

spectacular and the company is exposed to risks, such as currency fluctuations, hedging, forward exchange contracts, foreign government intervention, and protectionist policies, etc.

Strategy appears to be one of acquisition and divestment, unbundling those parts of new businesses that do not fit. Progressive company, prudent risk management BUT does it always work?

## Corporate responsibility

Centrica are aware of the positive business potential of Corporate Responsibility and also the negative impact of poor performance. CR has been fully integrated into Group's risk management structures.

4 categories – Environment/Community/Marketplace/Workplace

### Environment

Have to manage the impact of operations on the environment. Energy efficiency programme set up. Warm-a-life programme for disadvantaged customers. 'Think Energy' education programme for Schools.

### Community

Various schemes – workforce raised funds for several charities. N. American company launched 'Direct in the Community' to help people with disabilities to have services related to housing. British Gas – Help the Aged scheme. Also Carers U.K.

AA Accessible Hotel of the Year Awards –ensuring equal access for disabled people in hotels (Disability Discrimination Act – 2004)

AA – Foundation for Road Safety Research

One Tel – working with the Samaritans – donating 1p for every call put through to the Samaritans via One Tel's service.

### Marketplace

Services to visually impaired and deaf people. British Gas 'here to help' scheme to help tackle poverty. Households offered advice on energy efficiency measures.

### Workplace

Centrica try to help employees get the right work/home balance.

Training for all employees regarding how to treat disabled people. Also hired disabled. British Gas recruited 200 engineers targeting the long term unemployed.

AA – Investors in People Award.

Health and Safety – very important

Steps taken to help deter violence towards gas engineers, debt collectors and roadside patrols.

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## **Direct Energy and Energy America**

All facts previously discerned. In addition new brand role out has commenced.  
Under which brand? Map shows distribution of businesses across Canada and North America.  
Need to further drill down to gas/electricity, residential and business segments.

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Move into home services with acquisition- Greensource and Enbridge.

### Appendix 2

European energy customers-electricity and gas CENTRICA- no 3 – 19million Euros  
But in market capitalisation terms Centrica is no 10- 14billion Euros.

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Household market opening dates. Opportunities for Centrica in Spain, Netherlands but also Italy, Germany, France, Austria, Portugal, Switzerland etc. plus wider EU community-Scandinavia and Eastern European countries.

100m Households open to competition by 2004

Check European map for other countries

UK has very high levels of competition. However, the rest of Europe has medium to low or very low levels of competition so Centrica need to act fast- European strategy needed as well as North American.

**Question** Devise a European market strategy to capture the residential household gas and electricity market.

### Appendix 3

European utilities market

Product focused grid- very useful.

Omnibus survey- customer relationships not deep across the group. Problem with single product occupancy is that the customers are liable to switch-brand promiscuity.

### Appendix 4

Putting a value on brands. Coca Cola – the brand **is** the business. Brand value is the net present value of the future profits. Brand development is much more one of finding new market opportunities than simply launching brands against the established players.

## **Cause related marketing**

More than company conscience. British Gas – Help the Aged campaign (1999) It was felt that the company should use its business expertise to address the issue of keeping people warm in winter. It touched the hearts of people of all ages and the company knew that it would be supported by their diverse customer base. 30,000 older people die in the UK due to cold related illnesses. Cause related marketing – strategic yet a reasonable way to address relevant social issues and business marketing objectives. This has a positive impact on brand equity year on year. Positive development of brand as socially responsible. 98% staff awareness, 50% participation. Positive relationships with governments, regulators and opinion formers, positioning British Gas as a company that far exceeds legislative and regulatory obligations. Used media to increase awareness

and exposure 'Warm Hearts Week' and 'Alone at Christmas'. Campaign success is measured on a regular basis so future campaigns can be improved. British Gas also measures the business benefits of working with Help the Aged by Mori's evaluation of the British Gas corporate image, employee satisfaction surveys and British Gas commissioned research into customer acquisition and retention rates.

Research also shows that the partnership between British Gas and Help the Aged has sustained a positive public perception of British Gas. The result of the recent Mori survey revealed that about 57% of people who are aware of the partnership feel better about British Gas. British Gas has also exerted pressure on Government to increase energy grants from £700 to £2000 . Also winter fuel payments have risen from £20 to £200 . British Gas has supported the Help the Aged age discrimination in 2000. This is all positive PR for the company.

### **Possible Questions**

- 1 What European branding strategy should Centrica adopt to maximise sales and profitability, especially in emerging markets?
2. What branding and positioning strategy should Centrica adopt in its North American market to improve sales and profitability?
3. Prepare a strategic market entry plan to capture a slice of the lucrative energy market in Europe.
4. Devise a marketing plan to make Centrica a global player in the energy industry.
5. Prepare a relationship marketing campaign which will effectively increase customer loyalty and their life time value to Centrica.

6. Centrica is at the crossroads in its development and growth. Prepare a strategic marketing plan which will ensure continued domination of the home market and negate the marketing strategies of International predators.
7. Prepare a communications plan, which will increase sales and profitability internationally.
8. What pricing strategy should Centrica adopt in its North American markets in the light of complexities in the forward purchasing of energy, currency fluctuations, and the consequent issues of customer churn?
9. To become a truly global player, Centrica need to form a strategic alliance with a major international company. Prepare an outline strategic review to make this happen.
10. How can Centrica raise awareness of One Tel and encourage customers to switch?

## **Standard Ratio analyses**

### **Centrica 2002**

#### Liquidity

Current ratio (current assets: current liabilities)

2002

2001

4052: 4160 = 0.97:1

3445:3847 = 0.90:1

#### Trend

More liquid in 2002.

Typically low given good cash flow generated by financial services at this time (Goldfish)

## Questions

Is the extra liquidity the result of inefficiency (too much investment in current assets) or has it made the company more safe. (lack of liquidity can be fatal)

Acid test virtually the same given the very low stock levels.

Cash flow statement shows strong cash flow from operations (£717m pa)

## Gearing

i) Debt/equity (using market value of shares)

2002	2001
906/7,272	632/8,962
12.5%	7.1%

Very low geared company – has a lot of borrowing capacity

Trend – increase in gearing due both to extra borrowing (relatively small) and the 23% fall in the share price during 2002.

ii) Interest cover

Operating profit/interest payable

2002	2001
932/91 = 10.24 times	679/77 = 8.8 times

Comfortable.

Should this company be more highly geared, which is cheaper than equity finance and provides tax relief (interest is tax allowable)

## Profitability

a) operating profit /net assets

2002. 2001

932/2402 - 39%

679/1536 – 44%

b) operating profit/sales

932/14315 = 6.15%

679/12611 = 5.3%

High return on assets, BUT do assets reflect current value (probably they reflect original cost)

Low margins, although they have slightly improved,

c) earnings per share 15.2p

closing share price 171

price- earnings ratio 11.25

This is quite low (market average is around 17) and is largely an indication of relatively low expectations about future growth. This is a 'defensive' share.

### **Efficiency**

a) Asset turnover = sales/total assets

2002. 2001

14315/8730 = £1.64

128400/7914 = £1.78

This shows that sales per £1 of total assets has declined. This may be due to slightly higher margins being achieved.

b) Debtor collection = debtors/average daily sales

2002

2001

$3524/14315$  divided by 365 = 90 days

$2726/12840 /365 = 77$  days

this is quite high and has increased. There may be an issue about the credit control process followed by this company.

d) creditor payment = creditors / cost of sales divided by 365

2002

$3155/11328$  divided by 365 = 102 days

2001

$2871/10224/365 = 102$  days

atahese look high and are again distorted by the fact that this company operates a lot of services. No trend.

### **General comments**

A complex set of accounts due to its many subsidiaries.

Overall comments are only 'averages' – one would like more segmented information about the different parts of the group.

Overall,

-this is a highly liquid company. It has high cash generation – this may account for its relatively low cash balance£28m at the end of the year.(it generated £717m cash from its operations during the year.

It is relatively low geared. Combined with above this is a low risk investment for shareholders and its low p/e ratio makes it a defensive share.

Low profit margin on sales. Again this is only an average across the group.

Relatively low efficiency. Asset turnover not great and there may be issues about

credit control.

Other points

The company is active in takeovers and selling off parts of the business i.e. the accounts are not 'stable'. There was a big issue of shares during this year, but mostly to provide for employee share options.

This company needs to be more ambitious.