

# Texas Electric Deregulation Entering With A Bang Or A Whimper?

By Michael Richarme

**Electricity deregulation has begun in Texas, not with a bang but a whimper. Despite aggressive promotional campaigns, the average Texas consumer still isn't convinced there is much value in switching providers. Interest does appear to be higher among commercial and industrial companies, but they aren't stampeding to change providers either.**

On January 1, 2002, retail electricity deregulation became official in Texas, allowing millions of consumers and businesses to switch to a provider of their choice—with a few exceptions. Municipally run electric companies, electric cooperatives, and El Paso Electric are exempt from competition for a few years.

Prior to the launch of deregulation, a six-month pilot test was enacted that allowed a limited number of consumers and businesses to switch providers so transfer processes and behind-the-scenes databases could be tested. During the pilot test, the Texas Public Utility Commission (PUC) and most of the electricity providers mounted large publicity campaigns to inform customers of their upcoming options.

The campaigns—consisting of billboards, television and radio ads, and direct-mail pieces—

generated significant billings for quite a few advertising agencies, but didn't do a great deal to heighten interest among consumers.

In Dallas-Fort Worth, an exploratory survey of household electricity decision-makers was conducted the day after deregulation took effect. Among the findings were:

- Educational campaigns mounted by the PUC and electric companies were at best only somewhat successful, with respondents rating their knowledge of deregulation as “fairly high.”
- Of those respondents eligible to switch providers, a large majority indicated they had no plans to switch in the next six months.
- Of those respondents who planned to switch in the next six months, most said they were considering only one other company.
- New Power and Shell Energy were mentioned most frequently as companies to which respondents were considering switching. Both of these companies are new entrants into the retail electricity market rather than existing electric companies moving into new markets.

Because respondents were drawn entirely from Dallas-Fort Worth, this exploratory survey cannot be viewed as scientific. Though respondents were diverse demographically, they may not be representative of the state's population.

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However, some trends are clear. It appears that retail electricity deregulation in Texas will begin this year with mixed results at best, and the number of consumers switching from one electricity provider to another will be quite moderate. Moreover, until the electric companies overcome consumer inertia with a sound value proposition, most consumers won't switch.

Beginning to understand this, many Texas electric companies are scrambling to conduct their own research in hopes of finding the winning equation. Those that are not doing research most likely will learn their lessons the hard way—one lost customer at a time.

So where does this leave electricity deregulation in Texas? The real battleground for incumbent electric utilities appears to be large industrial and commercial accounts. Though highly visible, as in the case of a recent switch by Texas Instruments from TXU to Reliant Energy, with a two-year, \$50 million per year contract changing hands, these accounts tend to be extremely price sensitive and generally not the most loyal customers.

Movement by these customers can cause large fluctuations in both revenue and operating expenses, and the visibility of these accounts may serve as decision influencers for the larger undecided consumer base. Again, astute electric companies are conducting in-depth research within this customer base, trying to discover the combination of attributes that will prevent defection to another retail electric provider.

The research itself isn't enough, however. Providers also are going to have to develop a plan of action based on a clear understanding of how buyers think and on a reasonable projection of the results of their strategies. The nature of deregulation, converting a highly structured and regulation-dependent market into one in which free choice reigns, requires some consideration of the extremes of strategic options.

Across the United States, the markets for electric utilities are generally monopolistic, with a single utility granted the right to provide electric service to all customers in a given area. Over the past 100 years, this has created a significant amount of brand equity for the incumbent utility. In the interest of stimulating competition, state regulatory agencies

are deregulating the electric utility markets in their jurisdictions, allowing additional entrants to compete for customers in the incumbent's formerly protected territory.

For incumbents, the time has come to defend their territory against these new entrants, though with some significant regulatory restrictions. Incumbent utilities typically are given a fixed price reduction from the regulatory agency, which must be offered to all customers for a fixed period of time. In addition, the incumbents are forced to unbundle generation and transmission services from their retail business, as well as offer wholesale electricity to all entrants at the same wholesale price they offer to their retail divisions. Thus, competition exists at the retail level, not at the generation or transmission level.

The incumbent electric utilities know they will be unable to maintain their former 100% market share. Consequently they have been engaging in active marketing campaigns to emphasize their long histories in their markets, stability, reliability, and other key attributes. The incumbents are testing various positioning advertisements and campaigns aimed at keeping the most profitable customers in their fold.

The incumbents are generally burdened by existing cost structures developed under regulated market conditions, such as expensive downtown facilities, attractive compensation and benefits packages, elaborate customer service and billing systems, and expensive marketing campaigns. For many incumbents, it will be a major challenge to transform into retail marketing structures that can serve both household consumers and commercial/industrial customers.

In the deregulation race, entrants can be divided into two types. The first type is a prospecting incumbent from some other market, looking to replace lost market share in its home market with incrementally gained market share in other markets. These prospecting incumbents bring credibility from their existing electricity business, but may not have any brand awareness within the new market.

One possible strategy for these prospecting incumbents is to provide national account services for all of their large commercial and industrial accounts, accenting one unified bill and one point of customer service for all locations. A major challenge for the prospecting incumbents will be to identify

appropriate markets in which to enter, and to develop an efficient and effective “out of market” retail marketing and service operation.

The second type is a new entrant, formed specifically to participate in deregulated energy markets. These new entrants do not have home markets to protect and operate strictly as a marketing arbitrage entity in each market they enter. This entrant focuses on increasing brand awareness by emphasizing additional customer service, simplified billing, and lower prices.

The new entrant will have a limited physical presence in the market, as customer service, billing, and most marketing functions can be handled from a central location. This strategy will be applicable most often to small businesses and consumers. The major challenge for the new entrant is to establish awareness and credibility, entering the consumer consideration set when the opportunity for switching is presented.

The ultimate scenario from the perspective of existing electric utilities is a duopoly market. In this scenario, incumbent A enters the market of incumbent B, and incumbent B enters the market of incumbent A. The two utilities are able to fend off new entrants and establish a stable duopoly with limited competition.

Overtly moving to this type of strategy is precluded by antitrust legislation, but it seems to be a natural extension

of legislation adopted in many states. However, this does not work in situations in which incumbent A moves into many markets to acquire national accounts, and reciprocal entry by incumbent B into incumbent A’s market is not countered. In this case, the first mover will have a decided advantage.

From the perspective of new entrants, the most intriguing scenario is one involving a highly fragmented market in which new entrants compete against a sluggish, unprepared incumbent utility. Without another “reputable” utility brand to absorb consumers wanting to switch due to grievances, the incumbent will lose customers who cannot be safely offset by entry into the prospecting utility’s market. Doing so would elicit a competitive response by the prospecting utility and exacerbate the problem in the incumbent utility’s market.

Based on the data presented above, it appears the monopolistic or duopolistic market scenario will be maintained for consumer accounts over the near term, and a more fragmented market will emerge for commercial and industrial accounts. The similarities to the deregulation of the telephone market two decades ago are striking, and it is highly likely that a similar pattern of initial competition, followed by reduced prices, higher levels of innovation, and a subsequent market consolidation, will occur in the retail electric-ity market as well. But not very quickly.

## About the Author

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