Shaping the future of business energy

Inenco's guide to transforming your **energy buying strategy**

Introduction

Businesses are facing their tenth successive year of rising energy costs. Finding ways to mitigate against increasing prices and reduce energy bills is a key focus for many energy professionals.

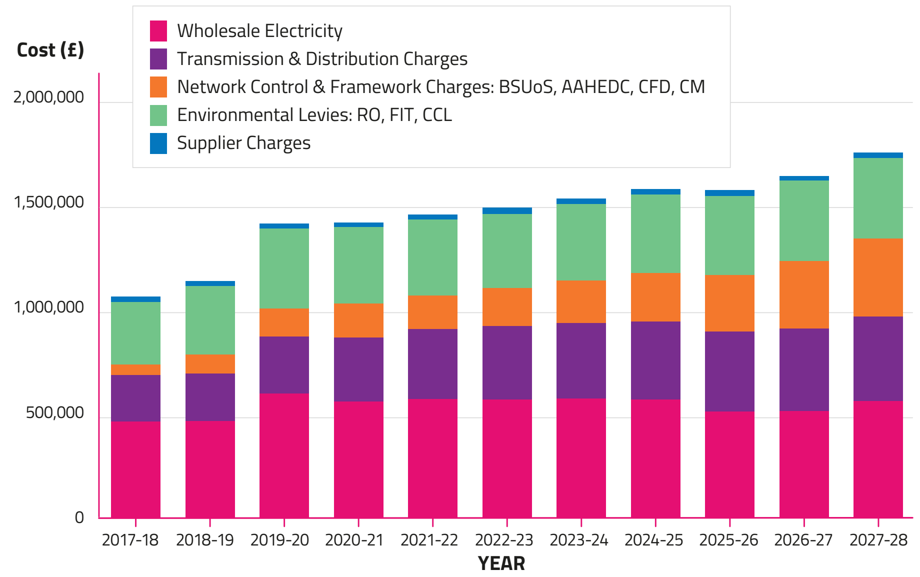
This is an increasingly difficult task: the increases have been fuelled largely by the cost of supporting more low carbon generation and upgrading infrastructure to accommodate a changing energy system. This means there's now pressure on both sides of the bill, with increases in both wholesale (commodity) and non-commodity costs (taxes, levies and system charges).

In 2018, volatility returned to the wholesale market following a period of relatively flat commodity costs. Low European gas storage levels, high carbon prices and rallying oil prices combined to boost wholesale costs to levels we hadn't seen for almost two years. Whilst a mild winter 2018/19 brought commodity costs back down to relatively low levels at the beginning of 2019, the ongoing political uncertainty in the UK means that the market is likely to remain volatile for the foreseeable future.

Non-commodity costs are also rising – in fact, they now make up around 60% of business bills. Support for renewable and low carbon technology has increased: the Contracts for Difference (CfD) levy. The Renewable Obligation (RO) levy and the Feed in Tariff all rose at rates well above inflation in the last 12 months. With the Capacity Market levy set to more than double this year (once reinstated), and the Climate Change Levy (CCL) also increasing significantly since the end of the Carbon Reduction Commitment (CRC) in April 2019, organisations of all sizes are likely to have felt the impact of these increasing charges.

Mitigating the impact of rising costs

With commodity and non-commodity costs increasing, organisations are facing a 'double whammy' of a rise on both sides of the bill. But this doesn't mean they have to resign themselves to higher energy bills. By taking a savvy approach to procurement and focusing on energy management, businesses can effectively mitigate the impact of future cost increases on their bottom line.



Your buying strategy

With non-commodity costs now making up over half of business energy bills, energy managers may prioritise energy management over perfecting their procurement strategy – but an integrated strategy creates the opportunity to optimise both approaches to drive savings.

One size doesn't fit all

The optimum procurement strategy will be different for every business, as it will depend on an organisation's unique requirements. For some, focusing purely on unit rate will be the best option to drive down costs, while others may be looking to boost their sustainability credentials by securing renewable supplies.

However, there are three key questions energy professionals should consider before starting the procurement process:

Is a fixed or flexible contract more suitable?

There are a range of different procurement products on offer, but they largely fall into two main categories: fixed contracts and flexible contracts.

For more information on fixed and flexible contracts, go to page 3.

What's my organisation's appetite for risk?

Risk is a key consideration when it comes to procurement, as some products will be inherently riskier than others depending on exposure to the fluctuations of the wholesale market. It's important to remember, however, that there will be a level of risk involved in any contract – fixed or flexible.

To find out more about risk, go to page 5.

Could I benefit from external support?

Whether you're looking for a fixed or a flexible product, working with an independent consultant can help you to find the best deal for your business and optimise your energy price through expert trading.

For more information, go to page 7.

Fixed or flexible

When buying energy, businesses will need to decide whether a fixed or flexible approach is best for their organisation. Here's an at-a-glance view of what they involve:

	Fixed	Flexible
Summary	**With a fixed price contract, you make a single transaction at the prevailing commodity price. This is the price you pay for the duration of your contract**	**With a flexible contract, you make multiple buying decisions throughout your contract. You decide when you buy and how much energy you buy each time**
Key benefits	▪ Price certainty, as you know what you will be paying for your contract duration	▪ Less risky than locking in one single price ▪ Multiple buying decisions mean you can apply a strategy
Risk considerations	▪ Risky due to big market volatility and inability to sell back	▪ Can have the same risk as fixed, unless you deploy an effective risk management strategy to mitigate this risk
Who does the product suit?	▪ Businesses that require price certainty or do not have the in-house or external expertise to make multiple buying decisions	▪ Businesses that have either in-house or external expertise available to make savvy buying decisions

There's another Option

Clearly, there are benefits and risks to both fixed and flexible procurement products, which can make it difficult for energy managers to decide which approach will benefit their business the most.

Optimum energy buying strategies can provide businesses with a good compromise. To access a portfolio energy buying strategy, however, businesses will need to work with an energy consultant – particularly those organisations who want to enjoy the benefits of flexible purchasing but who do not consume enough power to meet the flexible contract threshold. These businesses can opt to enter a portfolio, where their volume is aggregated with other businesses to meet the threshold whilst still enjoying a tailored risk management strategy executed for their individual requirements.

Our Options procurement strategy provides average price savings of £10K per £100K spend

At Inenco, our Options product enables organisations to take a tailored approach to energy buying, that perfectly balances risk and reward. We work with businesses to determine their appetite for risk, and then spread their volume across up to four different purchasing strategies under their pre-agreed risk parameters.

Each Options strategy has its own level of risk and budget certainty, and we fully manage purchasing decisions for our customers, so it's hassle-free. Options is also available to businesses of all sizes, as we can aggregate smaller business' volume together with other clients of similar profiles and trade the volume together as one portfolio.

The risk myth

When considering procurement products, an organisation's appetite for risk will be an important factor in finding the right deal.

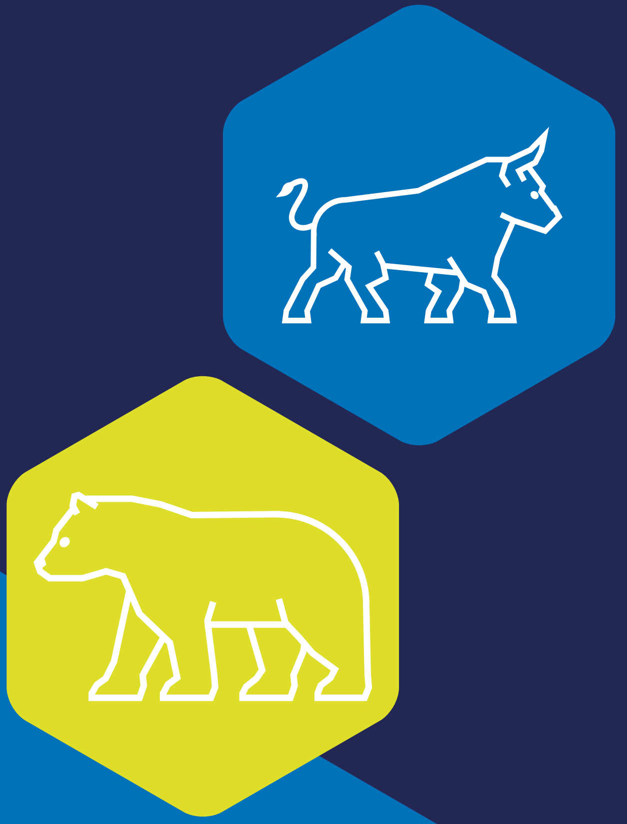
Risk-averse businesses often see fixed contracts as the 'safest' option, as it gives them price certainty for the duration of their contract. However, fixed contracts aren't without risk – a risk premium is built into fixed contracts, which means that they will pay more than cost for the energy they use.

Many businesses that lock into fixed contracts also make the mistake of waiting until just before their renewal date before they look for a new fixed contract. This means that they must settle for the prevailing market price – whether that's high or low.

With flexible contracts, businesses may not get the budget certainty that fixed contracts provide, but they can choose when they buy and how much energy they buy every time. This enables them to mitigate the risk involved.

For example, there's limited risk involved in a capped strategy, which enables businesses to set a price cap on the maximum amount they're willing to pay for their energy. With a price cap in place, businesses can take a flexible approach and benefit from falling markets while also having budget certainty. A prompt strategy, on the other hand, involves organisations buying energy in the day-ahead market for the next day/few days, which means they must pay the current market price – high or low.

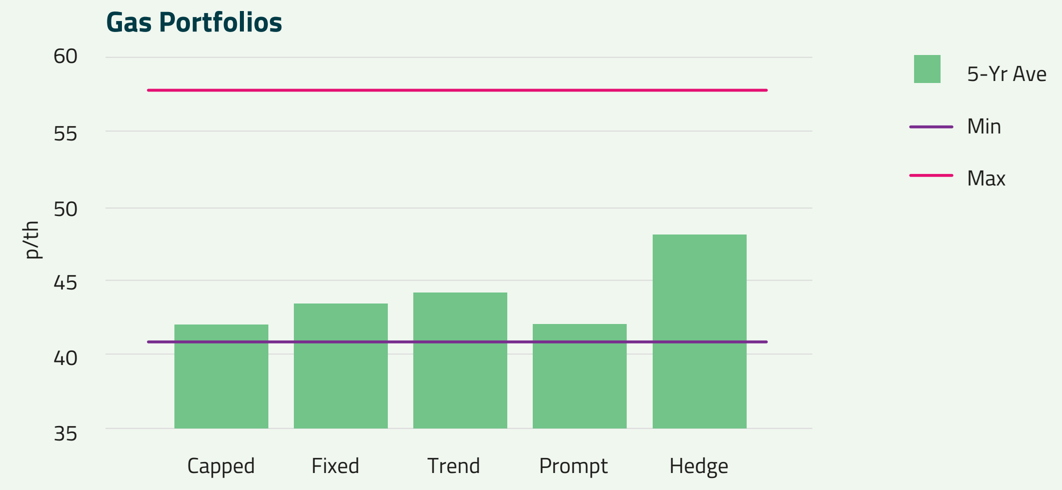
So whatever an organisation's appetite for risk, they should be able to find a fixed or flexible approach that meets their requirements.

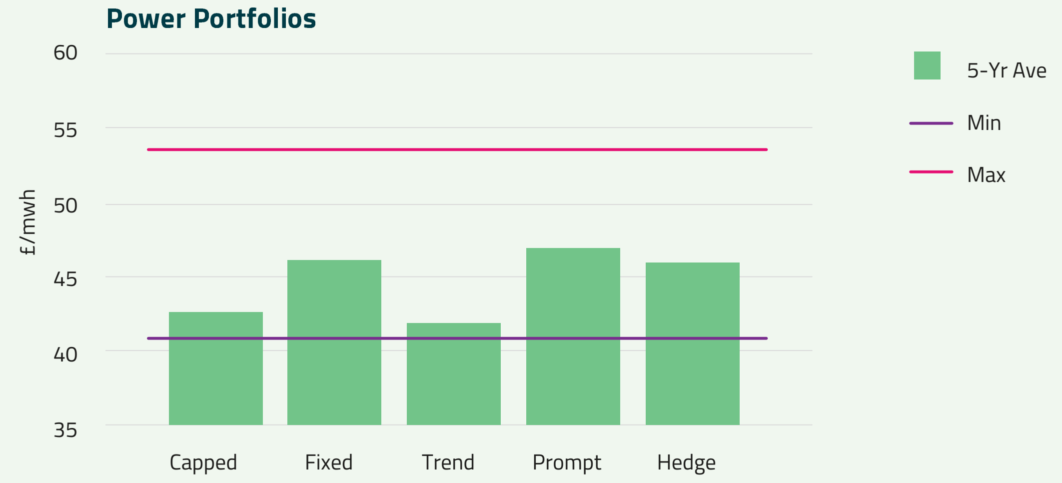


Putting strategy into action

With the commodity market in a constant state of flux, it is impossible to say how a particular procurement strategy will perform.

The graphs below show how various strategies could perform in the same market – while they are examples only, they do highlight the key differences between a fixed and flexible approach.





External procurement support

When considering their procurement options, many businesses will need to decide whether they have the time, capability and in-house resource to find the best deal for them.

That's where having external support from an energy consultant can really help – here's how:

Expertise on tap

By working with an energy consultancy like Inenco, businesses gain access to industry insiders, with years of experience in everything from energy buying to achieving energy compliance. Energy traders monitor wholesale markets and study a whole range of factors to determine the best time to act, from one-off buying decisions to executing a flexible purchasing strategy over a period of months or years.

Impartial advice

Those that choose an independent consultant will benefit from access to the full market and get impartial advice on the best product for their business, as independent consultants aren't tied to any one supplier.

Increased product choice

Some products, including portfolio solutions such as Inenco's Options product, are only available through consultants.

Boosted capability

Energy consultants aren't just there to help businesses choose a procurement product, they can also provide ongoing support when multiple buying decisions are needed. Staying up to date with the energy market and buying at the right time can be complex and time-consuming, which leads many organisations to ask energy consultants to manage it all for them.

A holistic approach

Optimising their procurement strategy is just one of the actions businesses need to take to keep their energy bills down in the future.

The total cost of energy is the unit rate multiplied by consumption. Procurement strategies can secure a preferable unit rate to drive down costs, but focusing on how much energy is being used - and when it is consumed – is also vital to drive down non-commodity charges and make absolute reductions in consumption.

Flexibility is key

Some non-commodity costs, such as Transmission Network Use of System (TNUoS), Distribution Use of System (DUoS) and Capacity Market charges are charged depending on what time businesses use energy. During peak demand periods – particularly during the winter – these charges can be much higher than during periods of low demand, so organisations that can avoid peak periods could make significant savings.

Many businesses will have some element of flexibility when it comes to how much energy they use, and when they use it, and this can be crucial when it comes to avoiding peak demand periods. They don't need to be able to switch their consumption off completely, as even reducing their consumption by 10% or 20% during peak period could help them to reduce their costs substantially.

Focus on efficiency

While flexibility is a useful way to avoid high non-commodity costs, it's not available to all businesses, as some cannot shift their consumption away from peak periods. Whether or not they can be flexible, every organisation should be focusing on reducing their overall consumption through energy efficiency.

That's because reducing total consumption is the only guaranteed way to reduce costs on both sides of the bill. And the good news is that energy efficiency should be accessible for businesses of all sizes and budgets. Many of the most common measures, such as retro-fitting efficient lighting or encouraging staff behaviour change, can deliver returns in just a few years.

Top tip: With the **ESOS Phase 2** deadline on the horizon, many businesses will be identifying energy saving recommendations for their audits. Implementing these recommendations can be a great way to **reduce overall consumption**

Five tips from the experts

Creating an optimum procurement strategy can be complex, but it doesn't have to be. Here are five top tips from Inenco's energy buying experts:

1

Reduce consumption

The best way to minimise the risk of increasing costs is to reduce your overall consumption.

If your organisation is captured by ESOS, make the most of your energy efficiency recommendations. Make a plan to implement them and put it into action – start with those with a short ROI to see savings as soon as possible.

2

SMEs should shop around

While Ofgem has enforced an energy price cap, this does not apply to commercial customers, which means that many businesses are paying well above the market price for their energy.

If you don't switch your supplier before your current deal runs out, you're likely to be automatically switched to your supplier's out-of-contract rates – which can increase your energy bills by up to 50%. That's why it's important to shop around a few months before your contract expires, to make sure you've got the best deal for your business.

3

Embrace flexibility

Flexible buying strategies can particularly help larger businesses to hedge out when prices are low, and can potentially protect you from short or medium term increases in wholesale market costs.

A flexible approach won't be right for every business, but it's wise to fully explore whether your organisation could benefit from a flexible strategy. You may need to change your corporate governance or increase credit exposure, for example, but if it gives you more control over your energy buying then it may be worth it.

4

Review your demand profile

Now that non-commodity costs make up around 60% of business energy bills, **when** you use energy can make as much of an impact on your bills as **how much** energy you use.

While Triad charges are set to become more balanced in the next few years, there are still savings to be made by reducing your demand between the peak demand period of 4pm - 7pm – particularly during the winter. Take a look at your typical operations to identify any activity that could be shifted from peak charging periods to off-peak times.

5

Understand your consumption

You may have a half-hourly electricity meter that accurately measures your consumption in real time, but if you don't also have a sub-meter, you may not have the level of data you need to really get to grips with your consumption.

Consider investing in a sub-meter if possible, as with access to the more detailed information on your consumption, you can make more well-informed energy management decisions.