DEREGULATION AND UNBUNDLING – THE LINK
How deregulation and unbundling have made the electricity industry re-focus their thinking

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ABSTRACT
This paper examines recent literature to give a background perspective on the link between deregulation and unbundling, using the electricity industry in Victoria (Australia) as an example. Deregulation generally results in increased competition in an industry, and unbundling occurs when the components of a provider’s products and services are separated (unbundled) and available to the user. As a result of deregulation and unbundling, businesses need to understand more about their customers in order to differentiate themselves from their competitors by offering unique products and services. The electricity industry is undergoing deregulatory reform, and it serves as an interesting example to illustrate the processes.

DEREGULATION, UNBUNDLING AND THE ELECTRICITY INDUSTRY
In many parts of the world today, Governments are deregulating industries as they seek to increase competition by opening up markets to reform and removing pricing controls. As a result of increased competition, customers are expecting more specialised offerings from their supplier and a higher level of service. Deregulation can have many affects on a market, including a change in the number of suppliers or businesses in the market, and giving customers the opportunity to switch suppliers. In a deregulated industry such as electricity, which is a perceived to be a commodity per se, there might be little loyalty to the current supplier as there is little differentiation between suppliers who are seen as selling the ‘same’ product. This notion is supported by a survey conducted in the US by Market Facts which revealed that after deregulation many customers would consider changing their electricity supplier (from Market Facts survey) [7, p.77-98]. Therefore, for many customers the choice of a supplier could be based on price alone and research in the US has shown that the effect of deregulation has meant that ‘most customers (are) able to obtain innovative services at declining prices’[3]. But what are these ‘innovative services’ and how can business survive with ‘declining prices’? Most businesses should realise that if prices are to fall, they need to find other ways to make their customers spend money with them. Therefore, these companies need to consider the process of unbundling, learn more about their customers, and understand how they could change their offerings.

In today’s business environment the ‘typical’ customer is changing and now ‘demanding more value and more products and services … they want friendlier providers with better customer service’ [2]. Many businesses have found that traditional marketing methods such as segmentation and promotion are not enough on their own to sustain their market share and profitability, and therefore they have started to use another tool to differentiate themselves, namely unbundling. For the purposes of this paper, unbundling refers to when the individual components of a provider’s products and services are separated and made available to the user - either on their own or as part of a package. This is usually for an additional fee to those businesses that want to pay for them. Which components the customer decides to pay for will vary according to the benefit that these unbundled (or re-bundled) products and services will give them. Further, when developing unbundled products and services, it is important to consider consumer behaviour and the process by which consumers and businesses select a supplier. Therefore, unbundling and a knowledge of consumer behaviour can help businesses identify which individual components of a business’s offerings their customers want and need, and allow them to create unique products and services to meet these wants and needs. This means that when customers are evaluating different suppliers their choice can be based on factors other than price alone.

When unbundling is promoted to consumers, it can also have the effect of improving the business’s awareness and image. It can affect the business’ profitability if they can charge more for the unbundled components when they sell them as ‘packages’ (of re-bundled components), or separate ‘offerings’. It is important for the supply businesses to realise that consumers will consider using the unbundled products and services only if the associated value of these unbundled or
bundled products and services is perceived as being greater than the incremental cost of buying the service. Otherwise, it would not be worthwhile using that product or service.

While unbundling might initially seem to be a good idea, there are also down sides to unbundling and these issues as well as aspects of consumer behaviour have been discussed in the full paper.

THE ELECTRICITY INDUSTRY IN VICTORIA (AUSTRALIA)

The electricity industry has been examined in this paper as it is undergoing rapid deregulatory reform in many countries. It is an industry that is well suited to unbundling as the suppliers are selling the same product (electricity), and therefore they need to differentiate themselves from their competition to maintain or increase their share. In 1993, the electricity industry in Victoria (the State Electricity Commission of Victoria) was restructured and privatised into three independently operating divisions responsible for the generation, transmission, and the distribution and supply of electricity. Each of the three operating divisions was further restructured into separate businesses that were privatised. Within the distribution and supply division of the electricity industry in Victoria, five companies were formed and these companies initially operated as monopolies in distinct geographic areas of Victoria. Following privatisation, the customers in the distribution and supply division of the electricity market were further segmented and gradually deregulated according to the classification of business and residential; and by annual electricity usage - large, medium and small users. By July 1998, all large and medium business users of electricity (those businesses that used 160 Mwh or more pa.) had been deregulated and were free to choose their supplier. In January 2001, the remaining segments (small business users and residential users) will be deregulated.

So how can help electricity suppliers use unbundling and their knowledge of the consumer buying process to increase their share of the market? Because different consumer segments have different wants and needs, there is a need for different options to be available when buying electricity. The options for buying electricity have been summarised below.

Fig 1: Options for Buying Electricity

THE IMPORTANCE OF PRICE & BUILDING VALUE INTO PRODUCTS AND SERVICES

As mentioned previously, price is an important factor in the unbundling process, both for the supply company and for the customer. Businesses in a deregulated environment face the dilemma that while many customers want lower prices, the supply companies want to increase prices. Many authors [1][9][10][11] discuss price in conjunction with unbundling and the effect both factors are having on the structure and expectations of the industry. They agree that in a deregulated market, competition comes down to price and businesses that do not intend to lower their prices need to find ways to build perceived value into their products and services. This will have the effect of making price comparisons more difficult and giving customers an option other than price to base their decision about which supplier to use. In order to price unbundled products and services, the supply companies need to understand what customers will pay and weigh this up against the cost of providing these products and services. Marketing Research can be used to address these information needs by identifying the unbundled components and by measuring the relative importance of the products and services that consumers want from their supplier. Marketing Research can also be used to obtain an estimate of how much extra, if anything, customers are willing to pay for these products and services. Balancing customers’ needs and expectations with
the actual costs of meeting these needs and expectations will help electricity supply companies develop marketable and profitable products.

Many authors such as Nagle [8] have written about the need for unbundled items to be available to those customers that want them, and they have also discussed the positive effect this could have on their perception of the supply company. So how do we determine which unbundled products and services customers want and need from their electricity supplier? Work undertaken [2][3][6] has identified some of the unbundled components in the gas and electricity industries. Some of the components identified are generalisable across different industries, while others are specific to the gas and electricity industries. Some of the components, such as a better level of service are subjective, while others such as sub metering and power factor corrections are tangible. More details of these can be found in the full paper.

CONCLUSIONS

Deregulation and unbundling are complex processes that are typically linked and occur in privatised industries. They occur together because deregulation, which has opened up markets to competition, has meant that businesses have been forced to develop new products and services as part of their strategy to survive in the competitive environment. Unbundling is a complex process that uses Marketing Research to determine both the components that consumers want and the price they are willing to pay. Ideally, unbundling could have many positive effects including delivering the choice of products and services that customers want and need, at an acceptable price, and giving them criteria on which to choose between suppliers. For the business supplying the product or service, unbundling could increase their share of the market and strengthen their awareness and image. On the other hand, unbundling if not done properly, might not always be a good thing. For example, unbundling might not reveal what customers want, or, the business supplying the product or service the company may not make a profit if the unbundled or bundled offerings are not priced properly (if priced too low), or they might lose share (if priced too high). However, it is important to realise that unbundling needs to be done as cautiously and as thoroughly as possible, and that a business needs to constantly monitor their offerings and consider the influence of price to ensure success.

Further research is needed to explore these issues, and this has been outlined in the full paper.

REFERENCES


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