

CASE 4:

CENTRAL POWER



Firm Style	Interview Round
McKinsey, BCG, AT Kearney	2

Case Question:

Our client is a regional electricity monopoly. Due to regulation, its market will be opened to competition next year on January 1. There are no actual competitors at this time; however, the client would like ideas on actions to take in the short-term in order to better prepare for potential competitors. They have no control over pricing and cost-cutting during this time period.

Clarifying Questions & Answers

Provide the following answers only if the interviewee asks the corresponding questions.

Question	Answer
Do we know of any potential competitors?	None at this time. Central Power is facing the <i>threat</i> of market entry.
Do you have any information on pricing?	Not really; pricing is controlled by a government, so it is beyond our control and will be the same for any competition.
	Cont'd on next slide

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Clarifying Questions & Answers (cont'd)

Provide the following answers only if the interviewee asks the corresponding questions.

Question	Answer
Are there other markets Central Power can enter?	None at this time. Our engagement is focused on their home market.
How is Central Power organized?	Central Power has three divisions: 1. Sales and General Administration 2. Generation and Transmission 3. Maintenance and Repair
How many employees are in sales?	About one for every 1000 customers.
Does sales, customer service treat certain customer segments differently?	No, they treat everyone equally.
If there is a power outage, does Maintenance and Repair fix industrial clients first?	No, they dispatch in the order of the call they receive.
Has Central Power ever advertised or had a marketing campaign?	Not in recent memory.
Is Central Power undertaking any capital investment?	Not in the next year.

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Framework / Structure

This case is about customer retention within the home market. Since the client is a monopoly, market share is 100% and customer acquisition is irrelevant.

The analysis may include, but is not limited to, the following areas:

- Barriers to Entry
 - There is no actual competition to specifically target
 - The government is deregulating, so there are no possible external barriers
 - Internal barriers are possible, such as increasing switching costs and commercial attractiveness to customers
- Anticipation of Competitive Attack - Once the candidate sees the exhibit and realizes how attractive the industrial clients are, they can anticipate how a rational competitor would enter the market.
- Market Information
 - Revenue
 - Customer Segmentation
- Stakeholder Reaction - How will employees, unions, or local government leaders react to our changes? (There is no set answer to this, just ask the candidate what they think and see if it is logical and structured.)

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Note: Strong plans will anticipate the need to be competitive and draw on analogous companies or situations.

Less experienced candidates gravitate towards issues of pricing and cost-cutting. This is not a profitability case. Weak candidates will often explore growth outside the home market, such as expansion into adjacent markets. While interesting, this does not address the primary problem of what to do in the home market before deregulation. Avoid these tangents.

Steer the candidate to **customer retention**.

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Phase 1

Qualitative reaction and quantitative analysis of revenue data

Purpose:

1. Test rapid understanding of a basic chart

- Most candidates ask about revenue very early. Show them the attached exhibit and immediately ask, “What is your reaction to this data?” Strong responses notice the differences between the customer segments.
- The “historical data” is irrelevant. If a candidate starts to ask about it or discuss trends, inform them that is a factor or population and government-determined prices, which are both beyond the control of the company.

2. Test basic arithmetic

Test basic math by asking the candidate (if they haven't already done so) to calculate the share of total revenue per segment and each segment's revenue per customer. If a candidate didn't notice the differences between customer segments already, this is a second chance. Note: I don't have a problem if a candidate wants to round the total revenue to \$250 MM from \$258 MM to simplify the math...

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	Industrial	Commercial	Residential
# of Customers	150	10,000	100,000
Revenue	\$150 MM	\$60 MM	\$48 MM
Revenue per Customer	\$1,000,000	\$6,000	\$480
Residential Customer Equivalents	2083	13	1
Fraction of Total Revenue	150/258 = 58%	60/258 = 23%	48/258 = 19%

NOTE: the math is really basic, but there are a lot of zeros that tend to trip up candidates. Most strong candidates write out the problem to avoid error, even if their math is facile. Now is a good time to diagnose how well they handle orders of magnitude. If this is a problem, here are some suggestions for the candidate.

Method A – Write out the numbers and cross out the zeros:

$$R\$ = \frac{\$60MM}{10,000 \text{ customers}} = \frac{60,000,000}{10,000} = \frac{60,000,000}{10,000} = \$6,000 \text{ per customer}$$

Method B - Use exponents:

$$R\$ = \frac{\$60MM}{10,000 \text{ customers}} = \frac{6 \times 10^7}{10^4} = 6 \times 10^3 = \$6,000 \text{ per customer}$$

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3. See if candidate grasps key insight regarding higher value of industrial customers and uses it for convergent logic in Phase 2.

- By now, candidates should realize that losing a single industrial customer is similar to losing more than 2000 residential customers. Churn of industrial and commercial customers is lower too and it is easier to approach a few hundred “B2B” customers than one-hundred thousand individual homeowners, apartment renters, etc.
- If a candidate still needs help, ask them, “Let’s turn the situation around. Based on this data, if you were a competitor, which segment would you target?” They should realize industrial customers. If the candidate doesn’t verbalize that Central Power should target or defend the industrial customers, then ask, “OK, based on your insight about a potential competitor, what should Central Power do to pre-empt them?”

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Phase 2

Generation of ideas regarding customer retention improvements.

- Now that the candidate grasps that any action should be biased towards the smaller and higher value segments, it is time to generate actual ideas. This part of the case is extremely unstructured- there are no more data sheets or obvious answers.
- Assume Central Power is decades behind the rest of the business world- they have no website, send out massive paper bills, treat customers with the finesse of a huge monopoly, etc.

Purpose

Test candidate's ability to generate their own ideas with structure and logic

- The prime differentiator between weak and strong candidates is their ability to have an exploratory conversation that exchanges ideas.
- Strong candidates will announce that they want to discover ways of improving customer attachment (or retention, stickiness, etc.) to Central Power and begin to explore the structure of the company looking for areas to improve. They use a conversational style to ask questions. They typically draw on personal experience as residential customers of electricity (or another utility).

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- Also, they may ask about the organization of the company or use a “value chain concept” to structure their questions regarding the organization of the company. At each part of the company, they ask questions about behavior, customer service, etc. to see if we focus on industrial clients. Great candidates really have some out-of-the box ideas, such as energy savings, simplified billing, special websites, improved terms for accounts receivable, etc.
- You will know you have a strong candidate when they move methodically through the company and use their imagination. Let them continue on as long as possible by asking, “What else?” This is an opportunity to test a candidate’s ability to structure their reasoning and demonstrate conversation skills.
- For instance, they should be able to tactfully move the investigation to a new part of the company when they have exhausted their imagination. These meta-skills are more important than specific ideas, so feel free to make up whatever you want about Central Power’s operations.

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Here are some ideas to facilitate customer retention by building a stronger relationship or making switching more difficult:

a) Sales and General Administration

- i. Sign customer contracts
- ii. Increasing credit terms / days allowable for accounts receivable
- iii. Increasing the size of the sales force
- iv. Allocating sales staff to specific segments, since the value proposition is different
- v. Allocate special personal to high-value accounts
- vi. Reduce or simplify the billing process
- vii. Create a website for customers to manage accounts online.

b) Generation and Transmission

- i. Consider building substations or redundancy that improves reliability or quality for industrial clients.
- ii. Work with industrial clients to improve their energy efficiency

c) Maintenance and Repair

- i. Fix outages by order of customer priority, not first-come, first serve. (Besides, Industrial clients are more sensitive to power outages than residential customers)
- ii. Preposition repair equipment near clusters of industrial clients to reduce repair time.
- iii. Proactively visit clients to inspect their infrastructure or provide engineering advice

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Weaker candidates face typically fall in two groups:

Group 1 – Lost in the Sauce: Some candidates have no idea how to systematically generate ideas. Try and prompt them by asking about their own experience with a power company, or ask them to think of the value chain.

Group 2 – Lone Rangers: Other candidates will have a systematic approach, but will make assumptions and monopolize the conversation. They declare, instead of explore, their way through this phase. They will make up their own data and draw conclusions. For example, they might say, “Our client must be bad at customer service, so I would consider dedicating people to high-value clients.”

A real conversation should flow like this: “Do we know how customers feel about service?” Response: “They hate it. The number one complaint is “every time I call, I speak to someone new.” Candidate: “Perhaps we should dedicate some sales staff to high-value clients that we want to retain the most.” Response: “Good idea, what else?”

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There are two other meta-skills to evaluate:

- First, does the candidate explain their structure and line of reasoning? It should be “transparent thinking”. I use an analogy of a tour-guide. A strong candidate tells me where we are going with their plan, takes me through it, keeps me from getting lost when we go outside the plan, and brings me back.
- Second, due to all the ideas being generated, a candidate needs good note-taking skills. Strong candidates will circle ideas on their plan or make a list in the corner of the page. When it is time to make a recommendation, they can quickly cover ideas at a glance. Weak candidates will attempt to recall ideas off the top of their head, usually without total success.

End the case when you are out of time or the candidate is out of steam.

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Recommendation

The recommendation should include the following:

- The answer – We have developed several ideas for improving customer retention; all priorities should be biased towards Industrial customers.
- Next steps – Analyzing costs, potential ROI, and effects on stakeholders for particular customer retention initiatives.

Strong Recommendation

“By investigating the operations of your company, we have developed several ideas for strengthening customer retention in the face of competition. No matter which actions are undertaken, there should be a bias towards industrial customers who are more valuable as a group and on a per-customer basis. If any of these actions seem attractive to management, we can undertake more detailed analysis to support

Tepid Recommendation

Many times, students will say the same thing as above but with too much detail, too much length, or without enough structure. When they are done rambling, I ask them to say it again in 30-seconds or in three sentences. Sometimes it takes a few attempts, but it is more worthwhile than telling them later during feedback that their recommendation wasn't good enough. (Close only counts in horseshoes and hand-grenades.

Weak Recommendation

Weak recommendations are missing a unifying aspect, such as customer retention. They also fail to include the key insight regarding the preferential value of industrial customers. Further, they may include something totally off-base, like cost-cutting or pricing.

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Questions to Further Challenge the Interviewee

1. How do you think the employees (or another stakeholder) will feel about these changes?
2. What do you think it will be like working for a client that lacks a history of customer service?

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Exhibits

Revenue 2007

	Industrial	Commercial	Residential
# of Customers	150	10,000	100,000
Revenue	\$150 MM	\$60 MM	\$48 MM