

The Brattle Group

SUREWEST'S TRANSFORMATION AND ITS LESSONS FOR TODAY'S ELECTRIC UTILITIES

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INTRODUCTION

In the popular reality TV show Survivor, participants go through a series of contests knowing that only a handful of winners will ultimately be allowed to stay on the island where the competitions occur. In the late 90's, SureWest Communications – originally known as the Roseville Telephone Company – realized that it would have to play in its own version of Survivor to remain viable in the telecommunications business. Growing demand for new technologies such as cellular phones, broadband, mobile internet, and satellite TV were eroding demand for traditional wired phone and cable TV services while requiring new investments in infrastructure. As the number of new products and smarter technologies grew, customers expected more service packages to choose from and advanced technical assistance. After several years of wrenching and not always successful change, a very different SureWest (SW) is still surviving and even prospering “on the island.”

The telecommunications is not the only industry experiencing a game-changing shift. Electric utilities face the most disruptive changes to their supply chains and business models in history as developments in clean energy and energy efficiency requirements continue to drive new infrastructure investment. Eventual deployment of Smart Grid technologies will support these changes while redefining how customers interact with utilities. Some progressive utilities are responding to these changes and considering long term strategies to stay competitive. So far few utilities have actually begun seriously altering their business model and mission in response to these challenges. For utility executives considering examples of how other industries have adapted to new challenges and opportunities, some of SW's tactics may hold lessons for their ability to survive and succeed

SUREWEST FACES CHANGE

No immediate crisis triggered SW's transformation, nor did it occur rapidly or without hiccups. Throughout the 1990s, the company's traditional business as copper-based landline voice and data provider to 83 square miles of suburban Sacramento, California was growing. Yet the company saw that new technologies and competitors were rapidly emerging as threats to its core land line business, and that public policy supports for incumbent local-exchange carriers were likely to wither over time. In particular, SW saw wireless communications poised for very rapid growth and entry into voice and data by the cable companies, satellite services, and other rivals, large and small.

As with many utility incumbents, including most electric utilities, SW had relatively high brand recognition and customer satisfaction -- assets it knew it would have to leverage if it was to fend off larger, better-financed competitors. As it did not expect to be able to compete on price alone, it knew that it would have to compete on the quality of customer service.

Along with its name change, SW adopted an extensive and ambitious suite of product and strategy changes. It invested heavily in a local wireless system, placing it in competition with a

number of established and emerging wireless rivals, which it eventually sold to Verizon Wireless in 2008.¹ It purchased the assets of a bankrupt fiber over-builder in its own territory in 2002, giving it immediate fiber to the home (FTTH) passing 42,000 households and 5,000 triple-play customers.² Finally, it purchased a second service area in metropolitan Kansas City that had overbuilt an early hybrid fiber coax (HFC) network passing roughly 100,000 customers.³

As it made these changes, SW came to agree with many others in its industry that offering triple play service -- video, voice, and data over one delivery network -- was the safest route to a sustainable competitive niche. This decision was neither unique nor surprising; to this day, triple play remains the nexus of residential communications competition. What was surprising, however, was its choice of delivery technology. Instead of the much more common RF-based video and cable modem approach, it chose to be among the pioneers of digital video over broadband (IP-based video).⁴

This option played to their advantage, but it presented a huge implementation challenge. IP video runs over a home computer network wired with CAT-5 cable. Every single TV in their customers' homes had to be hard-wired by their technicians to SW's proprietary network (customers' computers also had to be connected, but these connections were more common, and could be wireless). To add to the challenge, IP video was more susceptible to interference than other systems, so the wiring had to be isolated and installed with care. And then there was the utterly crucial issue of making sure their customers knew how to use the system and could have the inevitable questions and problems dealt with quickly and effectively.

INVADING CUSTOMERS' PREMISES

Once upon a time, prior to telephone deregulation, the one and only phone company that served your home installed and maintained all of its phones. In that ancient era, telephone company employees sporting the ubiquitous Bell Telephone logo were an occasional and not unfamiliar sight within homes and offices. Their technological and wiring challenges were modest, but they cheerfully made sure every phone in your house was located where you wanted it and worked reliably.

In the early 1980s, when telecom deregulation began in earnest, SW and every other phone company stopped entering their customers' homes or even thinking about what technology sat

¹ "Verizon Wireless to Purchase SureWest Communications' Wireless Assets in Northern California," Verizon, January 22nd, 2008, <http://news.vzw.com/news/2008/01/pr2008-01-22.html>.

² "SureWest Acquires Winfire Assets," *Sacramento Business Journal*, July 15th, 2002, <http://www.bizjournals.com/sacramento/stories/2002/07/15/daily5.html>.

³ "SureWest Expands with Kansas City Data Center," Rich Miller, *Data Center Knowledge*, September 4th, 2009, <http://www.datacenterknowledge.com/archives/2009/09/04/surewest-expands-with-kansas-data-center/>.

⁴ "Cisco Helps SureWest Deploy Integrated Data, Voice and Video," Cisco Systems, 2003, http://www.cisco.com/warp/public/cc/so/neso/meso/chswd_sc.pdf.

inside them. As with today's electric utilities, their responsibility began and ended at the "network interface" on the outside of your house. Telephone companies kept their fleet of trucks, but their crews stopped doing inside wiring, and were not recruited, trained, or provisioned for anything other than outside work.

Selling IP video meant that SW would have to dramatically evolve its installation orientation. To deliver high quality, high-reliable IP video straight to the screen, the company had to own every bit of the installation, maintenance, and performance of the delivery network. This not only meant creating a workforce that learned to install a whole new in-home technology; it also required the Company to engage far more intimately with its customers, installing complex wiring all across their homes and making sure the installation experience, installation aesthetics, and especially the ongoing viewing experience was pleasing to the customer.

These imperatives caused SW to revise its installation and customer care procedures top to bottom. While the full chronicle of these changes would fill many pages, the changes can be placed in five categories:

- ◆ A totally revamped sales force and strategy;
- ◆ New Install Scheduling and Provisioning Methods;
- ◆ New Installer Hiring and Training;
- ◆ Expanded Customer Education, Troubleshooting and Customer Care; and
- ◆ A completely retooled back office system.

Although all these change areas are essential for success, for the sake of brevity we focus on changes in the sales operation and SW's unusual changes in installation and customer education. These areas illustrate much of the change in focus, resources, and strategy SW adopted in all its processes to change its fundamental competitive character.

SELLING FROM A STANDING START

Back in its traditional telco days before 1982 - 83, SW didn't need to do much selling. Even as late as the 1990s, its wireline installations – on which it has an exclusive franchise -were growing handsomely because of growth in the highly desirable area north of Sacramento up to the foothills of the Sierra Nevada mountains. With the entrance into and focus on the competitive network provider field during the decade leading to today, SW has had to build and hone its marketing strategies. The business market and the residential market, which is the focus of this article, are very different. Marketing to the households is divided into three areas: a pull strategy via telephone advertising, a retention channel for those existing customers considering switching away, and the main thrust of the direct team. The direct team is the "foot soldiers" who are the main source of SW's enviable growth.

The compensation for marketing and sales people is highly weighted on individual and group performance in getting and retaining customers. As a result of the overall marketing strategy SW has a lower turnover rate than its competition.⁵

The direct team faces the challenge of going door to door to tell the people in each new neighborhood where SW has committed significant capital investment and laid down its fiber network past every home or apartment. The direct team also has the goal of knocking on every door at least once each year. This is sometimes called the “loneliest job”, as there is only a modest chance of acceptance and SW is focused on keeping up the positive image of a small but high quality regional company. The salesmen and women must be able to communicate the superior performance of a fiber optic connection. SW has created a real team spirit in its direct marketers and, remarkably, reports that there is relatively little turnover.

As a regional company, SW takes a very active role in its communities, both within the Sacramento region and in the Kansas City area where it provides service. There are frequent appearances of SW tables at fund raisers through the SureWest Foundation, as well as active participation in local commerce organizations such as the Sacramento Metro Chamber of Commerce. SW has used so-called guerilla marketing, including customer appreciation events at Sacramento River Cats games, which is the local minor league baseball team. The strategy is successful; as surveys show SureWest is positively viewed as an involved, local company.

Intensive training is essential to the direct team. A new member of the direct team starts with four weeks of classroom training. She or he must be completely familiar with the SW service offerings, the network and technology behind it, and the billing system and back room operations. Then the new person goes out into the field, spending several more weeks working with an experienced supervisor. Any gaps in training can be identified and more training can be instituted. Door to door selling is a job of the most intense kind and, with its team approach, SW has developed the ability to find people who thrive at it.

The pull strategy uses the call center to make calls on potential customers. The retention channel has found through experience that when existing customers call to discuss disconnection, this can be a controllable situation. The phone people are trained to find out what is the source of the concern. In many cases, the phone person then can get a SureWest Pro service person into the loop and rectify the situation. SW’s residential broadband customer turnover rate of 1.4% per month during the first quarter of 2011 is lower than the industry average.⁶

⁵ “SureWest Investor Presentation,” SureWest, May 2010, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzgxNTcwfENoaWxkSUQ9MzgyMTIzfFR5cGU9MQ==&t=1>, accessed August 1, 2011.

⁶ “Jefferies 2011 Global Technology, Internet, Media & Telecom Conference,” SureWest, May 12th, 2011.

INSTALL SCHEDULING AND CUSTOMER EDUCATION

SW's transition from very little inside-premises work to a major in-home presence required a top-to-bottom revision of the installation and care experience.

The changes began with two key revisions in the installation process. First, each installation is coordinated in real time with the back office, so that each element of the installed service is connected and tested at the network operations center as the install progresses. Without automating these pre-provisioning tasks, testing and troubleshooting the install could not begin until after all the inside wiring was completed, which would stretch the install well beyond the target maximum of four hours for -- the longest period SW likes to require its customers to remain at home while they install.

The second, more unique feature of the revised install process was the division of the installation force into two parts, physical installers and specially-trained customer education agents known as "SureWest Pro's." As the installation is wrapping up, the physical installer notifies the SW Pro and the latter comes to the home to meet the new customer. While the installer finishes the job, cleans up, and double checks to make sure everything is working properly, the Pro focuses on introducing the customer to the new system -- showing them how each remote control works, explaining the menus and screens, double checking that all the computers and homes are working, and explaining customer care procedures in case any trouble crops up.

Technically, the division of the installer force in this fashion means that every installation requires two truck rolls rather than one. Nonetheless, SW has found that this approach allows it to train its installers to focus on the skills and customer interactions involving the physical location of network elements -- "where would you like the set-top box, Mrs. Jones?" -- while the Pro's become experts in how to teach customers how to get the best use out of their system and self-diagnose the most common troubles. The approach is a nearly foolproof way of avoiding the worst possible install outcome: a customer who calls to say "it was working when the installer showed me but now I can't get it to work." This continued innovation around the customer installation process has also supported meaningful results to the bottom line: 30 day go-backs, or repeat truck rolls to a customer's home within 30 days of the original installation, have dropped from 12-15% a few years ago to below 7% today.

These changes are perhaps the most customer-visible among dozens of other complementary changes summarized above, including intensive training and monitoring of its installers, redesign of its back office systems, and cross-training of its 24-hour customer care specialists so that one phone call can diagnose and fix any part of the triple play package. Together these changes have enabled SW to achieve 61% customer triple play penetration, lower-than-average customer churn, and profitability sufficient to restore part of the dividend the Company eliminated early in

the Great Recession.⁷ While there is no such thing as a long-term victory in the communications business, SW remains “on the island” and is rated positively by its Wall Street analysts.

LESSONS FOR ELECTRIC UTILITIES

There are many, many differences between the power and communications industries, and between today’s electric incumbents and SW. Perhaps the largest difference is the fact that communications competition occurs via competing end-to-end networks, whereas we are likely to have only a single power grid for decades to come. Electric utility sales will be displaced by substitutes for network services, not rival networks -- or in less abstract terms, by customers generating their own power coupled with on-site storage. Additional threats may come in the form of small, community-based generation startups.

A second, related difference is that electric utilities face threats from a new generation of firms who want to provide services directly to customers that reduce electricity usage, including intensive hour-to-hour management of customers’ power demands. Many of these firms are already well-established in the commercial and industrial sector, including Gridpoint, Johnson Controls, EnerNoc, and many others, and a few are already selling to residential customers. Here there is an analog between these energy service disintermediators and the so-called “over the top” video providers now coming on strong.

Widespread residential bypass of the first set of challenges are neither commercially nor technologically feasible at present, and probably a bit farther off in the distance than the threats that forced SW to adapt. Home-scale distributed generation (DG) is still substantially more expensive than utility-provided supplies.⁸ For example, customers-install photovoltaic power is at least 25¢/kWh after today’s tax incentives, while power from natural gas generators is only about 6¢/kWh (excluding, in both cases, backup, delivery and firming power where needed).⁹ Nevertheless, DG has been getting successively cheaper, and it is destined to continue to erode traditional grid-based sales in gradually increasing amounts.

The second set of challenges also differ between telecoms and power, as the exclusivity of the power network means that most customers will continue to take service from electric utilities in one form or another. Independent “energy services” providers will position themselves between the utility and the customer, but they will not eliminate the utility’s kilowatt-hour sales or delivery charges, only reduce them significantly, and in doing so gain the customer’s loyalty and

⁷ “Jefferies 2011 Global Technology, Internet, Media & Telecom Conference,” SureWest, May 12th, 2011.

⁸ Please see: “Annual Energy Outlook 2011,” U.S. Energy Information Administration, April 2011; “Reinventing Fire: Bold Business Solutions for the New Energy Era,” Amory Lovins and Rocky Mountain Institute, 2011; “The Impact of Clean Energy Innovation,” Google, June 2011; “Smart Power: Climate Change, the Smart Grid, and the Future of Electric Utilities,” Peter S. Fox-Penner, Island Press, 2010.

⁹ “Solar Subsidies are saturated,” H. Sterling Burnett, June 28th, 2011.

trust. Finally, the power industry remains far more regulated than the telecommunications sector has become, and is likely to remain so.

Nevertheless, there are enough parallels between the old Roseville Telephone Company and today's electric utilities to draw one lesson: electric companies must either get much more involved managing their customers' energy use or they will cede this part of the value chain, and the customer relationship that goes with it, to a wave of competitors. The technology for in-home management, from smart meters to the chips every appliance manufacturer is already embedding in their products, continues to penetrate the addressable market rather quickly. Someday in the not-so-distant future, a representative from some company whose main mission is to help their customers' manage their energy use will be a familiar sight in American homes. Will that representative wear a shirt with the local utility's label on it, or will the shirt belong to an employee from a company virtually no electric customer knows today? Without proactive strategies by utilities and cooperation from their state regulators, the answer is likely to be the latter.