Shaking up the energy mix

By Nigel Roberts

Providing new, secure and sustainable sources of energy in the U.K. today requires more than pipes and grids; Centrica chose a new business model and a growing roster of global partners.

When **Sam Laidlaw** (MBA ’81) took over as CEO of Centrica in 2006 it was a very different company to the one he now runs. Then it was perceived to be just the rather dull utility bits of the old British Gas that had been demerged in 1997 - simply marketing gas and power to U.K. consumers. Now he has transformed it into a rather more dynamic, vertically integrated energy company. “We could see then that energy prices were going to go up and we were going to be very exposed to volatile commodity markets. The only way we could build a defence against that was to become an integrated company that had our own sources of gas production and power generation.”

In the past six years, Laidlaw has made big investments in new sources of gas in Qatar and Norway and the company has also made significant investments in nuclear power in joint ventures with France’s EDF; so Centrica now part-owns all of the U.K.’s nuclear power stations with the French energy company. But Laidlaw’s ambitious plans to redesign Centrica are not finished: he continues scouring the landscape in both the U.K. and internationally. “The next step for us is to continue building out our renewables business. We’re going to add to our gas production so that we are going to become an even more integrated company. But also building our North American business, where we’ve got 7 million customers, by providing the gas to source those customers.”

“Strategy Trilemma”

This diversification of energy supply turned out to be a good move for the company since it gives them more control over gas supply. But Laidlaw acknowledges that the strategy needed for the power generation side of the business is more complex. He believes that Centrica faces a “trilemma” of contradictory pressures. First, they have to address energy security. Secondly, there are obligations to meet climate change objectives and reduce carbon emissions. And thirdly, they need to do all these things in an affordable way. “Solving that trilemma in a way that is acceptable for consumers and businesses in a world of slowing economic growth is going to be difficult.”

Diverse investment strategy

Centrica now has a varied investment strategy in an effort to maximise the use of its skills and resources while establishing partnerships with companies which have specific expertise in Centrica’s non core activities. Some of the investments - in gas fired stations for example - are direct while others, such as nuclear stations, are done in partnership with EDF. They also have a stake in various wind farm projects.

This pick and mix approach gives Centrica flexibility to manage the energy mix in an uncertain and volatile market. “It’s a combination of organic growth, adding customers through the normal sales process and in our upstream business of gas production, we’re having good success with our exploration programme and adding reserves organically. But we’re also supplementing that with acquisitions. Where we think we have particular expertise and competence we like to own and operate. Where there are others who’ve got stronger capability like nuclear we’re very happy to be a minority partner.”

The need for a support mechanism

Laidlaw believes that the energy market in the U.K. is at a very delicate stage. “The government has announced a programme of energy reform, which in principle is a very good thing. The intention is to incentivise low carbon generation. But everyone knows at current market prices you can’t make an economic case for building either onshore or offshore wind farms and can’t make a case for nuclear. You have to have some form of support mechanism.”

Laidlaw believes that the lack of detail in the government’s energy reform programme is creating uncertainty about investing in nuclear and renewables. Unless this uncertainty is resolved and as long as pricing and support for renewables is not clearly defined, then investors are not going to invest in new energy sources like renewables. In several European countries, governments have withdrawn subsidies and support for renewable energy sources and that has made investors cautious. “Investors will want to know that the investment climate is going to survive and that those incentives are going to remain in place and not be taken away as soon as they’ve built the plant.”

Avoiding a demand crunch

Laidlaw wants more investment in gas storage as well as building relationships with a wider group of foreign gas suppliers if the U.K. is to avoid a demand crunch sometime before the end of the decade. Depending on how quickly the economy recovers and grows, demand could outstrip supply in the U.K. some time between 2017 and 2020. “We need to build more gas storage because at the moment most of the gas that comes into the U.K. is potentially divertible. So if the price of gas in Korea or Japan is higher on any given day, much of that gas can go to Asia rather than going to the U.K., which leaves us potentially vulnerable.”

The energy market has evolved and changed a lot in the time that Laidlaw has been leading Centrica. His flexible approach to strategy and changing market currents seems to be paying dividends with shareholders and latterly with consumers too, who have been critical of the company in the past for raising prices to bolster profits. The company is a very different corporate beast from the one he took over in 2006. It now generates energy from a mix of different sources with a range of new partners. But gas is still the core driver in the business and Laidlaw believes it will continue to be so for the foreseeable future. The only difference now is that gas-powered generation is cleaner and greener and that security of supply is more assured because of a more flexible approach and diverse sources of supply.

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