

Removing Risk from Your Risk-Management Strategy: 4 Steps



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The current state

Proactive risk management can help limit organizations' exposure to energy market volatility. Successful strategies apply forward-looking market analysis and factor in global, regional and national nuances.

Of course, managing risk is imperative because risk and volatility are unavoidable. The last 40 years of crude oil prices, which have a direct impact on the cost of electricity and natural gas, show how often and drastic energy expenses can swing.

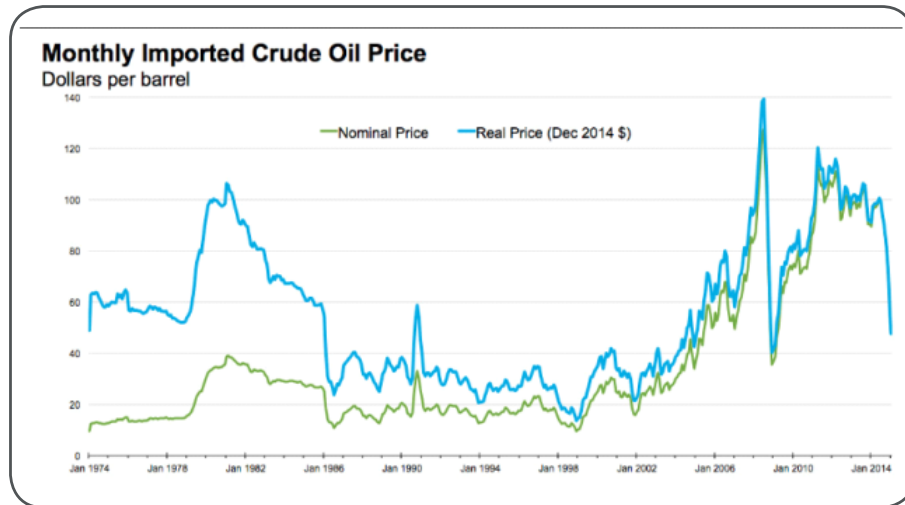


Figure 1: 40-year Crude Oil Price Profile

The ultimate irony, however, is that developing and implementing a strategy to deal with the inevitable is often fraught with risk. However, that's one thing within a company's control. Follow these steps to build an effective, lasting approach to managing energy price risk. The outcome? Lower costs. Less exposure. More clarity.





1. Build your strategy on independent intelligence.

The choice of a consultant can have significant ramifications for energy procurement managers – some unexpected and some unwanted. Just as the right decision can lead to properly managed costs, the wrong decision can result in unforeseen energy costs. It is essential for procurement managers to familiarize themselves with each consultant's services and the associated costs.

Key considerations include:

- Ensure any third-party consultant can access multiple price sources and independent market intelligence reports. This will allow you to accurately benchmark prices provided by suppliers.
- When trading energy with a supplier, it is critical to have these scenarios independently checked:
 - Smaller volumes that don't transact on the open market
 - Other "untradeable" or "residual" shapes (the energy left over once all the tradable amounts have been executed)
 - "Default arrangements" (the prices for energy that an organization requires/ consumes, but doesn't know to buy)

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- Make sure you fully understand which services you will pay for before signing an agreement. Many energy suppliers provide commissions to consultants that add clients to the customers the supplier serves. In addition, be sure to have clear cost itemization for your risk management services directly from the energy supplier, as costs can be bundled into supply contracts.
- Get a guarantee on actual costs, which is vital when there are multiple parties in the supply chain. Suppliers make margin on the physical supply of energy and the trading of that energy, as well as risk management services. An independent third party can ensure the client only pays for risk management support.
- Know the track record and performance of your risk management consultant. Procurement managers need to determine if the consultant can deliver by evaluating the consultants' longevity, references and case studies.



2. Establish clear governance at the outset.

Out of date, incomplete or vague risk policy documents. Inconsistent implementation. Weak processes. They can all result in an inappropriate level of risk. To counter this threat to financial well-being, risk management clients need to set processes that will deliver the expected standard of service.

An example of where this governance is particularly important is energy price hedging strategies, trading history and roles & responsibilities.

To ensure hedges are correctly applied, you'll need:

- Clear visibility of hedging records
- The ability to validate and reconcile these hedges

Delays to the independent confirmation of transactions increases the risk of financial loss from incorrect or unauthorised transactions.

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This is especially important when you leave volume on a default/spot index where the process of validation is more complicated. When a supplier or organisation related to a supplier provides a risk management service, it is important to understand who maintains the trading history and records, and validates those trades.

In the absence of third-party validated invoices, auditors may have difficulty signing off accounts. They will likely encounter issues with items that haven't been through the independent validation process.

That's why it's important for procurement managers to select a consultant that can offer two primary services:

- A segregation of duties across risk and trading teams
- Robust standards of conduct, process control, performance reporting and trade validation.

Having a third-party recreate invoices from the bottom-up ensures costs being applied are accurate and reflective of both market add-on costs and transactions made.

Many consultants or suppliers in the market promote a specific type or approach to risk management. It is important to seek a balanced view.





3. Seek simplicity, efficiency and flexibility.

It is important to select a consultant that can help you develop and meet your risk management objectives across multiple regions and respond to your needs now and in the future.

Choosing a supplier or other vendor for risk management services alone can be inconvenient and inefficient. This approach often leads to one provider that delivers risk services, another to validate invoices, and still another that provides sustainability services or other energy cost management support. Selecting one supplier for all services establishes consistent, efficient, scalable and aligned services. A single-source third-party allows organizations to deal with one centralized account manager for all related inquiries. A Global Glass Fiber Company achieved 4.3% annual savings of the total electric power cost taking this approach.

Companies that require risk management across multiple countries, whether centrally or regionally managed, should strongly consider third-parties with a global footprint and demonstrated expertise. The end result is flexibility of deployment and a consistent approach across multiple commodities and countries. This simplifies and standardizes governance and management without compromising quality.

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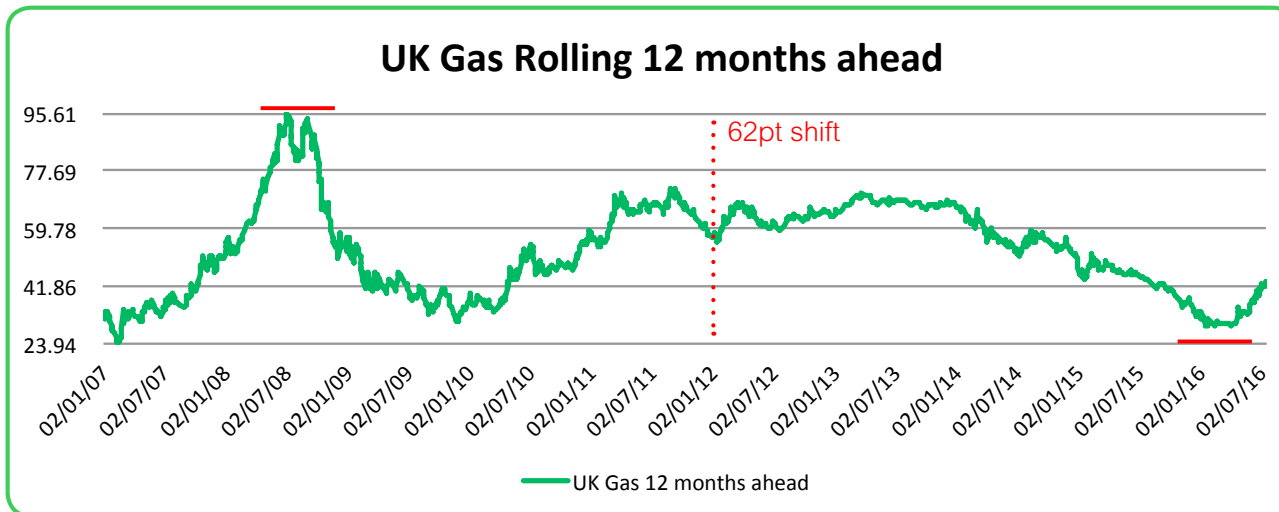
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4. Set KPIs and track results.

The energy market has experienced unprecedented volatility over the last few years with dramatic cost swings from day to day. In order to insulate themselves from such uncertainty, organizations need to put into place an energy strategy that meets specific company objectives.

In the realm of energy risk management services, an expert partner that can offer impartial, strategic advice can be invaluable. Both parties need to be clear on the KPI targets for success and measure against these throughout the contract - these could be regarding the execution of trades, report formats, deliverable timeframes etc.

With the appropriate strategy, a business can be more agile and respond quickly to market spikes — and participate in most of the market drops seen in the last 10 years. The savings achieved could even approach the levels shown below, showing the huge differences in contract value between buying at the top and buying at the bottom.





Aldi Case Study

“We at Aldi Stores (Ireland) Ltd are extremely happy with the service and benefits achieved during our long and established relationship with Schneider Electric”

Eoin McGovern | Property Director

With over 110 stores across Ireland, Aldi is a major fixture in the country's retail landscape. In order to help reduce its carbon footprint, as well as gain savings, Aldi Ireland takes extensive measures to manage its energy carefully. The uncertain state of energy prices led Aldi to look more strategically at their procurement.

Aldi engaged Schneider Electric's team of experts to implement a dynamic procurement strategy. Schneider Electric employed their Risk-Optimisation approach, combined with the Risk-Managed Portfolio (RMP) methodology. Flexible contracts were used as opposed to traditional fixed-price contracts, with the new approach yielding year-over-year savings. Aldi saved 24% on electricity during the first year of the strategy. The following year, Aldi saved even more - 32%!



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