Quarterly Snapshot: The Energy Sector

In this special report, IBISWorld analyses the key trends affecting the energy sector over the past three months.

Legislative changes have caused competition in the energy sector to grow and increased the production of renewable electricity

Ofgem’s efforts to increase competition in the energy sector have encouraged an influx of new energy companies over the past five years. In June 2018, there were 73 active energy suppliers in Great Britain, having risen from just 24 in June 2014. During this time, the share of the market held by the ‘big six’ energy supply companies has fallen, as millions of Britons have been lured by the cheaper prices offered by new entrants. Energy suppliers were also hit by a cap on standard variable tariffs (SVTs), which was implemented on 1 January 2019. The cap was imposed by Ofgem to give 11 million customers a fairer deal on their energy bills, saving SVT customers on average £76 per year. Despite turbulent conditions, 2019 has provided some respite for energy suppliers. Ofgem’s SVT price cap was raised by 10% in April, reflecting higher energy wholesale costs at the end of 2018. Ofgem also announced that entering the market will be tougher for prospective suppliers from June. Following the collapse of a number of low-cost providers in 2019, including Brilliant Energy, Our Power and Economy Energy, prospective energy suppliers will have to demonstrate sufficient funding, provide a customer service plan and face more stringent tests in order to reduce the risk of supplier failure. Nevertheless, competition remains fierce, and several major energy supply companies have issued profit warnings or have been forced to cut employee numbers to relieve some of the pressure facing margins.

Low margins and difficult trading conditions are similarly faced by firms in the Electricity Production industry (IBISWorld report D35.110). Domestic electricity production fell by 1.4% in 2018, according to provisional figures released by the Department for Business, Energy and Industrial Strategy (BEIS), while the volume of electricity imports grew by 17.4%. Despite only accounting for 6% of total supply, the United Kingdom is a net importer of electricity so imported electricity is essential for meeting domestic energy demand. The United Kingdom will lose access to the Internal Energy Market (IEM) once it exits the European Union, which could lead to supply disruptions and rising costs for both consumers and producers in Britain. Additionally, the introduction of trade barriers could cause supply chain issues for domestic energy producers, as World Trade Organization tariffs could be implemented on imports of both energy and production machinery.
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Sustainable growth
Despite troubles in the wider energy sector, the UK Renewable Electricity Generation industry (IBISWorld report UK0.003) has expanded rapidly over the past five years, with particularly strong growth being recorded in the offshore wind sector. The United Kingdom has the largest offshore wind capacity in the world, boasting approximately one third of global capacity in June 2018, according to energy trade association RenewableUK. UK Offshore wind production grew at a compound annual rate of 18.4% over the five years through 2018, and accounted for 8% of total electricity production in 2018 according to BEIS statistics. Total renewable generation accounted for 33.3% of electricity production in 2018, up from 15% in 2013.

While the United Kingdom is on course to meet its 2020 renewable energy generation target of 30% of total electricity production, suspension of work on the Wylfa nuclear plant in January 2019 created an electricity generation gap in Britain. The government therefore doubled down on its renewable energy expansion plans by launching the Offshore Wind Sector Deal in March 2019. The strategy sets out to increase investment throughout the offshore wind supply chain, with the intention of offshore wind accounting for one third of British electricity production (30GW) by 2030. The deal is expected to support unprecedented levels of investment in the offshore wind sector and is likely to fuel job growth throughout the supply chain.

Renewable Energy Directive
The Renewable Energy Directive 2009 established an overall policy for the production and promotion of renewable energy in the European Union. It requires the European Union to meet at least 20% of its total energy needs with renewables by 2020, through the attainment of individually set national targets.

The new Renewable Energy Directive 2018 is aimed at ensuring that the European Union remains at the forefront of renewables and is intended to help the European Union meet its emissions reduction agreement under the Paris Agreement. It establishes a binding renewable energy target of at least 32% for 2030, with a clause for a possible upwards revision by 2023.

<table>
<thead>
<tr>
<th>Year</th>
<th>Renewable electricity production (MW)</th>
<th>Share of total electricity production</th>
<th>Offshore wind electricity production (MW)</th>
<th>Share of total electricity production</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>21819.9</td>
<td>5.7%</td>
<td>1335.4</td>
<td>0.3%</td>
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<tr>
<td>2009</td>
<td>25208.0</td>
<td>6.8%</td>
<td>1753.9</td>
<td>0.5%</td>
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<tr>
<td>2010</td>
<td>26180.4</td>
<td>6.9%</td>
<td>3059.7</td>
<td>0.8%</td>
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<tr>
<td>2011</td>
<td>35212.3</td>
<td>9.6%</td>
<td>5149.0</td>
<td>1.4%</td>
</tr>
<tr>
<td>2012</td>
<td>41248.6</td>
<td>11.4%</td>
<td>7603.1</td>
<td>2.1%</td>
</tr>
<tr>
<td>2013</td>
<td>53213.3</td>
<td>15.0%</td>
<td>11471.6</td>
<td>3.2%</td>
</tr>
<tr>
<td>2014</td>
<td>64522.5</td>
<td>19.2%</td>
<td>13404.6</td>
<td>4.0%</td>
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<tr>
<td>2015</td>
<td>83363.8</td>
<td>24.8%</td>
<td>17422.7</td>
<td>5.2%</td>
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<tr>
<td>2016</td>
<td>83127.2</td>
<td>24.7%</td>
<td>16405.7</td>
<td>4.9%</td>
</tr>
<tr>
<td>2017</td>
<td>99329.8</td>
<td>29.6%</td>
<td>20915.9</td>
<td>6.2%</td>
</tr>
<tr>
<td>2018</td>
<td>11088.8</td>
<td>33.3%</td>
<td>26683.3</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

SOURCE: DEPARTMENT FOR BUSINESS, ENERGY AND INDUSTRIAL STRATEGY
Contracts for Difference

Growth in the renewables sector has previously been supported by Renewable Obligations and feed-in tariffs as part of the government’s Electricity Market Reform programme. However, both of these schemes have since been closed to new applicants, and the Contracts for Difference (CfDs) scheme has become the government’s preferred support mechanism in the renewables sector.

A CfD is a contract between a low-carbon electricity generator and the government-owned Low Contracts Carbon Company (LCCC), whereby the LCCC will pay the difference between the pre-agreed price of renewable electricity generation, or the ‘strike price’, and the average market price, the ‘reference price’. The scheme safeguards renewable energy producers from volatile wholesale prices and ensures revenue stability. As part of the Offshore Wind Sector Deal, the government will make £557 million available for CfDs over the next ten years to support low-carbon electricity generation, with the aim of increasing domestic offshore wind capacity by 2GW per year. In the short-term, energy prices could rise in Britain, as the cost of CfDs is covered by energy producers through a Supplier Obligation levy, which is eventually passed onto consumers in the form of higher energy bills. However, the scheme is likely to lower energy bills in the long-run, as the per-unit cost of producing electricity via offshore wind farms will fall with greater capacity, with the government aiming to make the sector subsidy-free in the long-term. However, higher energy prices in the short-term are likely to affect businesses across the UK economy. Manufacturing industries, in particular, tend to be highly energy intensive, so are likely to be most affected by energy price changes.
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Supply chain investment
Since 2010, the United Kingdom has attracted 48% of all new global investment in offshore wind. As part of the Offshore Wind Sector Deal, the industry is set to invest £250 million in the UK supply chain over the next ten years, with offshore wind-related exports expected to increase fivefold to £2.6 billion by 2030. Investment will go towards making British manufacturing firms more competitive in the global market and supporting SMEs to export for the first time. This will include focussed investment in research and development to fuel innovation in new renewable energy technologies. Export revenue is therefore likely to rise in renewable energy supply industries, such as the Engine and Turbine Manufacturing industry (IBISWorld report C28.110), over the next decade. The Electricity and Telecommunications Infrastructure Construction industry (IBISWorld report F42.220) is also likely to benefit from continued expansion in the renewable energy sector. Through investment certainty provided by the CfD system, the offshore wind sector is expected to invest over £40 billion in infrastructure by 2030. In total, the deal is expected to support up to 27,000 new jobs in the United Kingdom, many of which will be in coastal communities.

IBISWorld Industry reports used in this special report:
C28.110 Engine & Turbine Manufacturing in the UK
D35.110 Electricity Production in the UK
F42.220 Electricity & Telecommunications Infrastructure Construction in the UK
UK0.003 Renewable Electricity Generation in the UK

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