BRIEFING

Exploring the financial condition of the UK local energy business sector

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Highlights

- Local energy businesses in the United Kingdom share some common financial characteristics, but there are differences depending on how local they are. We explore their differential characteristics, and use our findings to suggest some ways to support growth.
- Highly local energy businesses are making a more limited contribution to the assets and turnover of the sector than other, less local energy businesses. This suggests that their activities in the United Kingdom energy market are currently limited.
- They are highly reliant on long term debt. Because repaying debt may have an impact on how businesses operate, the specific terms and conditions of such finance need to be explored further.
- Highly local energy businesses are also less profitable, which may mean that they are unable to invest in development.
- Access to appropriate financing mechanisms or instruments for local energy businesses is needed.

Summary

If local energy systems are to be an important part of the United Kingdom's net zero greenhouse gas emissions' targets, then it is important to understand how they work financially. Information about different financial indicators, such as liquidity, leverage, efficiency, and profitability, can help practitioners, investors, financiers, and policy makers to improve understanding of how well businesses operate.

In our first report, we estimated degrees of "localism" and "smartness" among legally-constituted energy(-related) businesses in the United Kingdom (UK), using a qualitative scale and matrix. We characterised the UK local energy business (LEB) sector as an emerging and diverse group of organisations, including a minority of actors with limited experience in energy provision. Based on this work, we now take a step further to examine the financial condition of the UK LEB sector using the same indicators of localism, alongside financial ratios. The latter are a well-known publicly-available metric used to gain insights into financial performance and profitability of businesses. Financial ratios and localism indicators are used in statistical analyses to provide insights into the financial condition of the sector.

Highly-local energy businesses included in our sample are distinguished by three characteristics:

- very limited contribution to assets and turnover of the LEB sector;
- high reliance on long-term debt, a very important element for these businesses;
- comparatively low profitability.

They may be owned by trusts or community groups, universities and local authorities, and can be structured as community interest companies, private cooperatives, and organisations with community group ownership shares or benefits. Conversely, private sector energy businesses with a shallower local commitment are, in most cases, in stronger financial condition. However, they do share some characteristics with highly local businesses, since some are also comparatively reliant on long-term debt.

Analysing financial ratios reveals further commonalities between differentially local energy businesses. The correlation might indicate, for instance, that specific financing and asset management strategies are exploited by energy businesses with characteristics in common, including the way they engage with localities. It might also indicate that all local energy businesses have commonalities that transcend techonology, ownership, and localisation. Differentiating between subsets of (local) energy businesses can help create appropriate market segmentation with the aim of customising finance mechanisms and localising public policies or incentives. The findings in this work support the validity of those in our previous report, and suggest the need for further evidence from quantitative analysis.

Future work should address other elements of interest. This should include the specific reasons for the current financial status of the local energy sector; in this sense, analysing terms and conditions of financing for LEBs is key.

Such analysis may require qualitative work through detailed survey of a representative sample of LEBs and should aim at delivering insights into how businesses are servicing (paying) their debts, as well as into whether businesses are financially distressed. Furthermore, the geographical aspects of LEBs and their performance in value creation, retention, and delivery at a local level should also be considered for further examination. The analysis should aim at addressing the following key topics:

- The kinds of value delivered to localities and other stakeholders by LEBs
- Whether the above-mentioned value can be measured, quantified or not
- Whether the value delivered by LEBs is exploited, retained, or transferred to other interested parties
- The potential improvement of social, economic, and/or environmental conditions of localities, and its relation with LEB creation and services

Policy recommendations

1. Sectoral development requires a standardised disclosure regime for business and financial information about companies. This needs to be in accessible digitalised format for analysis. The standard regime should include financial criteria as well as business technologies, installed capacity, benefits provisions, customers, and number of employees.
2. A policy framework should include the promotion of different financial mechanisms or instruments designed to meet local energy business needs, such as working capital, refinancing, and long-term (re-)investments. Economic science highlights various options: collaterals and covenants; partnerships in exachange for property or a stake in revenues; corporate structures based on Special Purpose Vehicles (SPVs); securitisation of small energy assets; closed-end funds and consumer stock ownership plans; long-term loans, bonds or debentures, and mezzanine debt, among others.

3. If private investments are insufficient, the provision of financial aid, guarantee mechanisms or monetary incentives to boost investments should be considered. When public funds are provided, these should be awarded based on degrees/forms of local commitment, business plans, and projected cash flows.

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About EnergyREV

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