



## Flexibility and Risk Management: The Perfect Partnership

Flexible energy contracts have been available for a while and more and more energy buyers are using them. The fact remains though that many businesses are failing to put in place adequate energy price risk management strategies to sit alongside flexible energy contracts. Here we take a look at the importance of energy risk management.

In a flexible energy contract, the terms of when and how much energy you purchase will allow for flexibility. For example, you may purchase a chunk or 'tranche' of energy at a fixed price for the duration of the contract but you then have the flexibility to build up to your full energy requirement by purchasing the energy on the forward market at different points in time. An energy market that is in contango – the price for energy delivered today is cheaper than the price for energy delivered next year – presents real significant value to those consumers able to purchase their energy needs on a flexible basis.

However, while there is value in flexibility, there is also risk. Prices move and can sometimes move dramatically in response to market information (the month of March is a perfect example of how events can drive energy prices). Having some or all of your energy volume unhedged will give you exposure to energy price movements, and while the aim is that these moves will hopefully be to your benefit, 'hope' is not enough. You will need to have in place a risk management system and a trading strategy. These will help your business achieve its energy procurement strategy without any unexpected surprises.

A risk management system, or 'risk rulebook', will set out the risks to be measured and valued and will state the 'risk limits' the business is comfortable operating within. **Risk limits help protect a business** and are the equivalent of going to the races with £100 knowing this is all you are prepared to spend. **Understanding and quantifying your energy price exposure on an ongoing basis is essential** as your risk position will change from day to day as forward prices in the energy markets change. The risk limits will also account for market volatility as well as unwind time (the time it takes to hedge an unhedged position). All of this will inform your procurement process – or trading strategy - throughout the duration of your flexible contract ensuring you hedge at the right times to maintain energy price risk at levels the business is comfortable with.

While this might sound quite onerous, there are tools and services available that can help you get started. They range from simple web based reporting tools to more sophisticated energy management systems, all of which will pull in the latest market prices and generate risk reports. Some suppliers are even offering risk management services although the potential conflict of interest should be considered.

So, if your energy procurement strategy allows for some energy purchasing flexibility, then your business has some energy price risk. It is important to quantify that risk and fully understand how a change in price will impact your energy purchasing costs. Doing this will enable you to manage those risks whilst capitalising on the flexible benefits as they arise. If you would like to know more about what Risk Management tools are available, then contact Powerisk for further information.