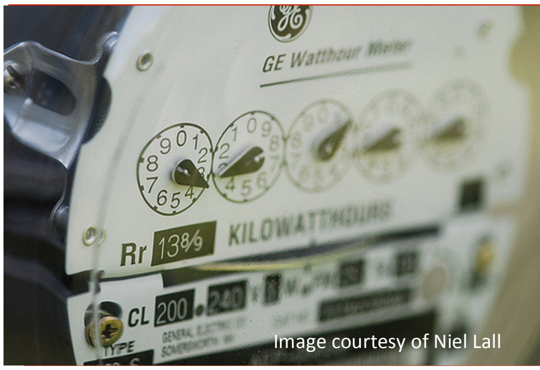

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Competition Impacts of Energy Tariff Options: There and Back Again

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A key function of the regulator in a liberalized market sector is preserving competition, and since the UK energy market privatized in the late 90's this has been a continuous point of investigation. The UK domestic retail energy market circa 2009 was, by several metrics, competitive on paper. By 2008 over 75% of customers – approximately 20M households – had switched energy supplier at least once, and 83% of the remainder were aware that it was possible to switch [1]. Where most authorities considered switching rates to be a measure of competition in the market, the UK had the highest switching rate in Europe and amongst any sizeable competitive energy market in the world [2].

However, when exposed to further scrutiny, these statistics revealed a demonstrably uncompetitive environment – the consequences of which were realized over the next five years. First, it was found that only a third of customers switching suppliers did so as a result of making their own enquiries rather than in response to being approached by a salesperson [3]. At this time, doorstep selling of energy tariffs was widely practiced, but was affiliated with serious complaints. Chief amongst these was the claim of misleading sales tactics, as nearly half of electricity customers who switched as a result of direct sales ended up with higher bills [4]. This finding was just one of many statistics that gave evidence for the high levels of consumer distrust and low levels of consumer satisfaction with energy companies. By 2013, the problem had exacerbated to the point where nearly half of customers distrusted energy suppliers to be open and transparent with their dealings with consumers [5]. For such a major industry, this was unacceptable.

In 2009, 18% of customers switched their electricity supplier [2]. By 2013 only 12% of customers were switching, turning the expectation that consumers would leave suppliers if they weren't satisfied on its head [6]. With such rampant dissatisfaction in the market, why then weren't customers exercising their ability to switch energy suppliers? The conclusion reached by the regulator was that despite the dissatisfaction, many consumers felt that the work required to find and switch to a better plan was not worth the effort, and that some consumers felt that they ran the risk of selecting an even worse tariff if they were to switch. In addition to the lack of trust and poor supplier conduct regarding customer acquisition, a large number of tariffs had become available on the market, many of which had complex arrangements and discount structures [5]. Consumers found it difficult and time consuming to find sufficient, straightforward information to make an informed decision about switching, causing many to refrain altogether [5]. One State of the Market report by the energy regulator Office of Gas & Electricity Markets (Ofgem) noted: "Combined with confusion and a lack of trust in the information available, many are left uncertain as to whether or not it will be beneficial to switch... Many consumers doubt that switching could lead to the kind of benefit (financial savings and/or improved customer service) that would justify their time and effort and the risk that things could go wrong"[5].

Ofgem concluded that there was weak consumer pressure on suppliers to behave competitively. In the absence of customer switching, the average domestic energy bill rose rapidly from £1095 in 2009 to £1232 to 2012 [5]. One common tactic involved recruiting customers to fixed-term deals at a competitive market rate, then subtly transitioning customers to a more expensive standard variable tariff (SVT) when the term expired. More insidiously, the "Big Six" energy suppliers who controlled 99% of domestic customers at the time made concurrent price rise announcements, suggesting – though not entirely proving – collusion [2]. When viewed as a whole, the domestic retail energy market was distinctly uncompetitive. The finalisation of Ofgem's Retail Market Review in 2013 and subsequent reforms represented a major regulatory intervention. It found that the domestic energy market was "characterized by weak competition between the incumbent suppliers arising from market segmentation and possible tacit coordination" [5]. Specific issues identified as hindering switching included complex tariffs, a lack of clear information about the tariffs, products and contract terms, and a lack of trust in dealing with suppliers [7]. Amongst the reforms put forth was a cap on the total number of tariff plans on offer by suppliers in an attempt to de-clutter the market. Additional reforms surrounding the presentation of information were also added to make tariff options transparent and easier to understand, including the creation of a standardised Tariff Comparison Rate and Tariff Information Label. Simultaneously, Ofgem also began developing a Confidence Code for switching services – particularly online price comparison websites – to create a standard that would inspire further trust in using such services to switch energy suppliers.

The subsequent impact on switching rates suggested that the intervention was effective. After hitting a ten-year minimum in Q1 2013, electricity supplier switching rates halted their downward slope and climbed 50% by Q1 2016 [8]. The usage of price comparison websites – such as uSwitch and CompareTheMarket—which broadly advertised their adherence to Ofgem's Confidence Code became a primary source for switching, as 47% who switched in 2015 used such services to compare plans [7]. Many of those switching also selected non-"Big Six" suppliers, eventually eroding their market share to around 87% [9]. While the impact was positive, the overall picture was still poor. Citing low consumer engagement relative to similar industries and a high penalty for "unengaged" consumers – an average £330 difference between their current supplier's SVT and the fixed term deal with a competing supplier – the Competition and Markets Authority (CMA) released a series of recommendations in 2016 intended to promote participation in the market [9].

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Amongst these recommendations was the removal of the tariff cap and the creation of a database of contact information for customers who were on their supplier's SVT for three consecutive years [9]. CMA concluded that the cap inhibited competition because, alongside other measures, it prevented the creation of innovative offerings. Testimony from the "Big Six" indicated that in response to the cap, they removed green tariffs – which were among the least commercially viable offerings – and other tariff structures aimed at niche or less profitable market segments – such as low-volume consumers [10]. Furthermore, suppliers also wanted the ability to offer reward plans paired with other services, discounted "smart home" packages, and more. Removal of the cap would allow for testing of new tariff plans which would theoretically enhance innovation in the sector.

While many large and medium suppliers testified that the removal would be beneficial, it is difficult to fully reconcile this with the outcomes achieved previously under a market flooded with potential options. Conversely, the parallel recommendation for the creation of a database of "unengaged" customer information was poorly received. Many parties who felt that access to this database would only mean that suppliers, switching services, and other parties would inundate these consumers with junk mail, adding further dissatisfaction.

The broad question looming over these recommendations is this: will this new intervention – which is essentially a negation of the previous one – bring about positive outcomes for the consumers? History suggests that this is not that case. From the business perspective, multiple opportunities now arise to prevent a regression to the previous state of affairs. No longer constrained by tariff caps, suppliers have the opportunity to create new tariff offerings, including the introduction of time-based rates and products that take advantage of the smart-meter implementation. With an abundance of tariffs options available, price comparison websites could see increased demand as well. New services, such as the Cambridge-based AIswitch, that aim to deliver significant savings through automated identification and switching of energy plans with minimal customer involvement have a distinct opportunity to boost and commercialise customer engagement.

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