

# Impacts and Implications of a Consumer-Driven Retail Energy Market



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## **1. The energy retail market today**

- How is it evolving and what are the challenges?

## **2. What are we doing in the short term?**

- Protecting consumers from price rises and enabling greater innovation and consumer benefits

## **3. How are we seeking to put the consumer at the heart of regulation in the longer term?**

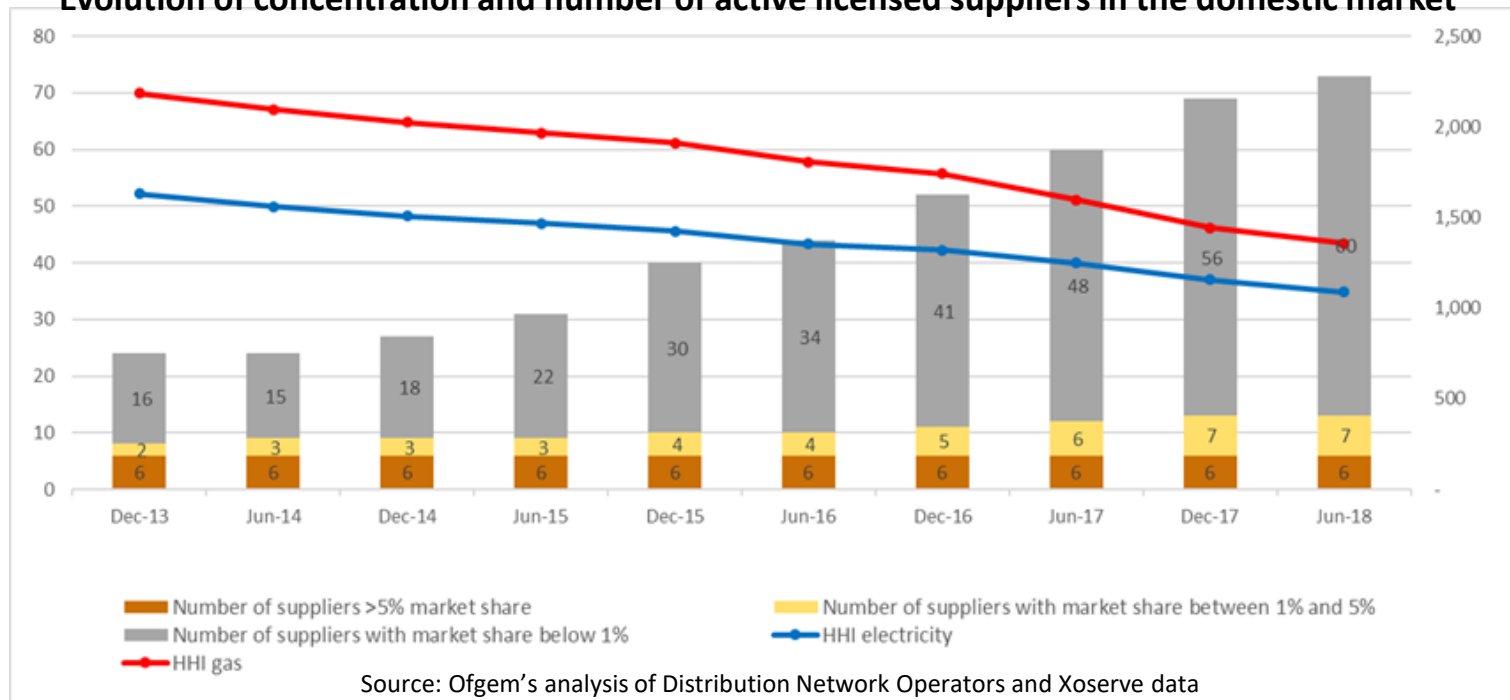
- Reforms to the 'supplier hub' model
- Changing how we understand consumer behaviour, through trialling of policies and better use of data

- Ofgem is the **Office of Gas and Electricity Markets**. We are a non-ministerial government department and an independent National Regulatory Authority, recognised by EU Directives.
- Our principal objective is to protect the interests of existing and future electricity and gas consumers. We do this in a variety of ways including:
  - promoting value for money
  - promoting security of supply and sustainability, for present and future generations of consumers, domestic and industrial users
  - the supervision and development of markets and competition
  - regulation and the delivery of government schemes.
- Our annual budget for regulatory activity is c. £50m.



- Increasing number of energy suppliers in the market - **73 active licensed domestic suppliers**
- A few new suppliers have experienced financial difficulties and some have exited the market
- The market is changing - technological innovations, new business models and some consolidation (e.g. SSE/Npower merger)

**Evolution of concentration and number of active licensed suppliers in the domestic market**





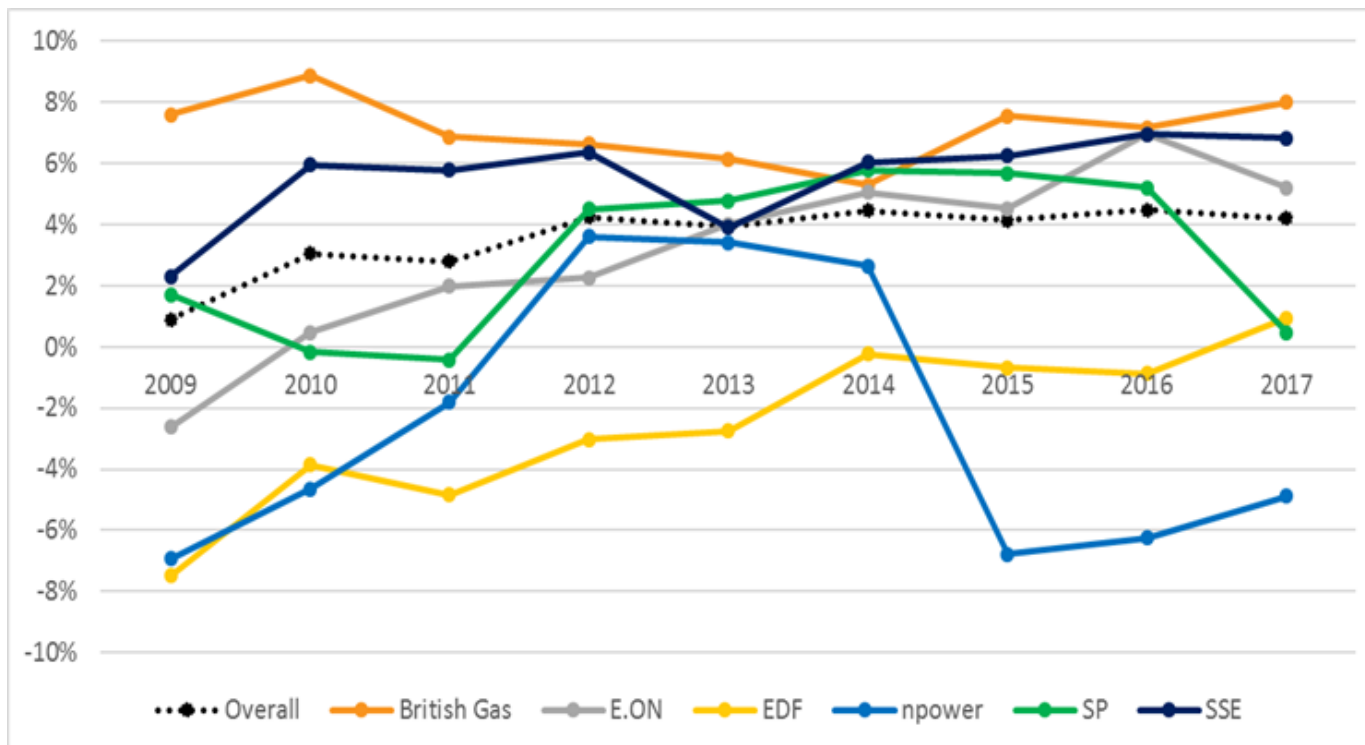
FINANCE AND INVESTMENT

**Energy auto-switching service  
gets Dragons' Den investment**



- Aggregate domestic supply margin was 4.2% in 2017. Profits vary across the six large suppliers but are falling overall – because of falling customer numbers.
- Notable contrast between the electricity (0.4%) and the gas supply margin (9.1%)

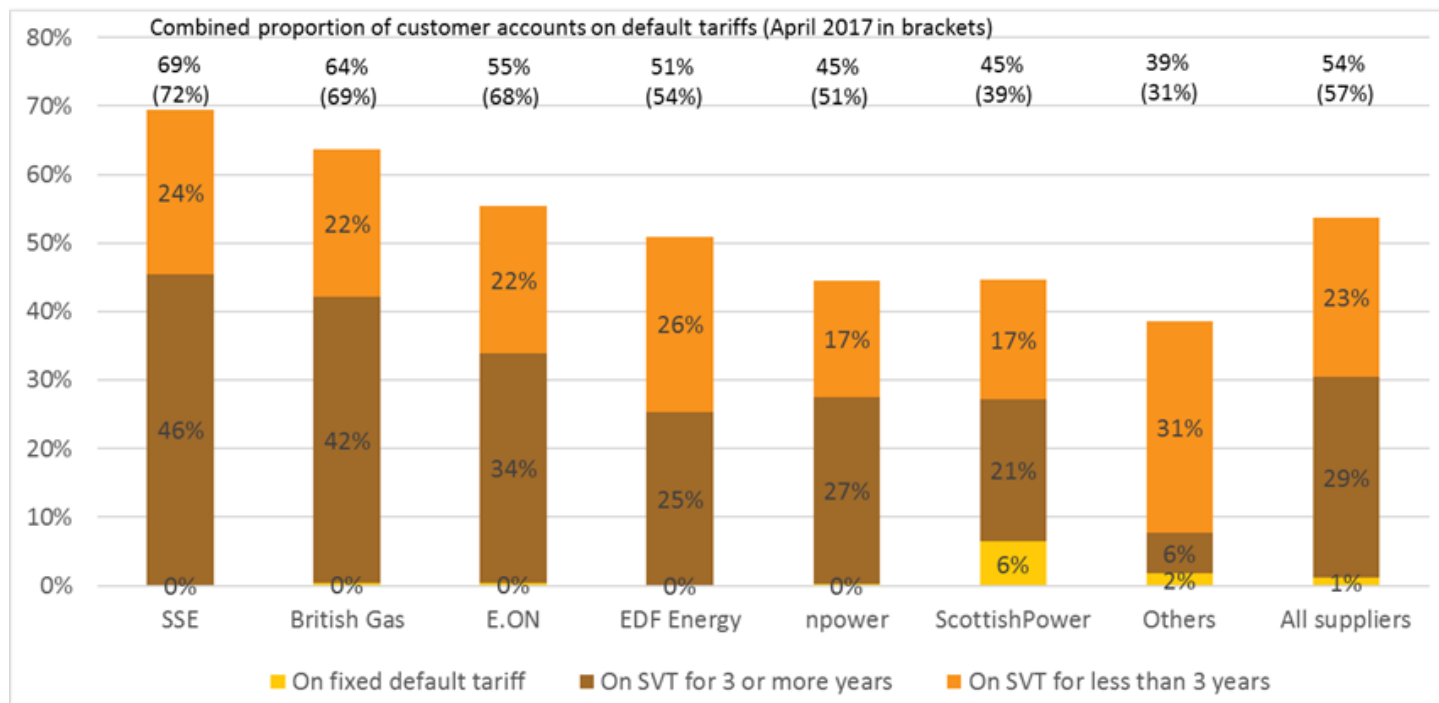
**Earnings before tax and interest (EBIT) as % of revenues**



Source: Ofgem's analysis of the six large suppliers' Consolidated Segmental Statement

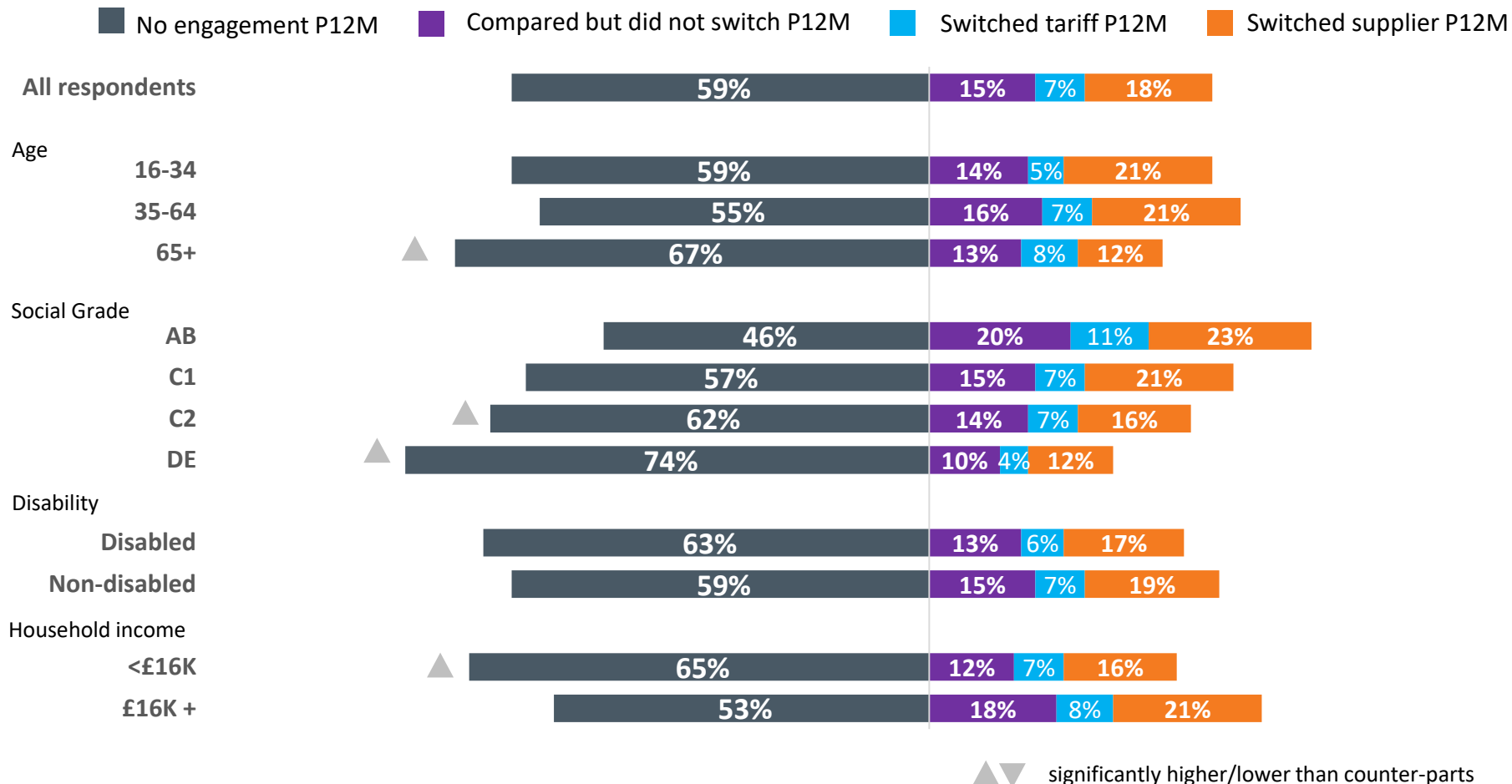
- Household switching rates are increasing – up to 19%. But over half of customers remain on expensive default tariffs.
- Price differential between average SVT price of the six large suppliers and cheapest market tariff = £320.
- Consumer satisfaction with suppliers is often low – six large suppliers typically near the bottom of Which?'s surveys

**Proportion of domestic customer accounts on default tariffs (April 2018)**



Source: Ofgem's analysis of gas and electricity customer account data by 28 suppliers

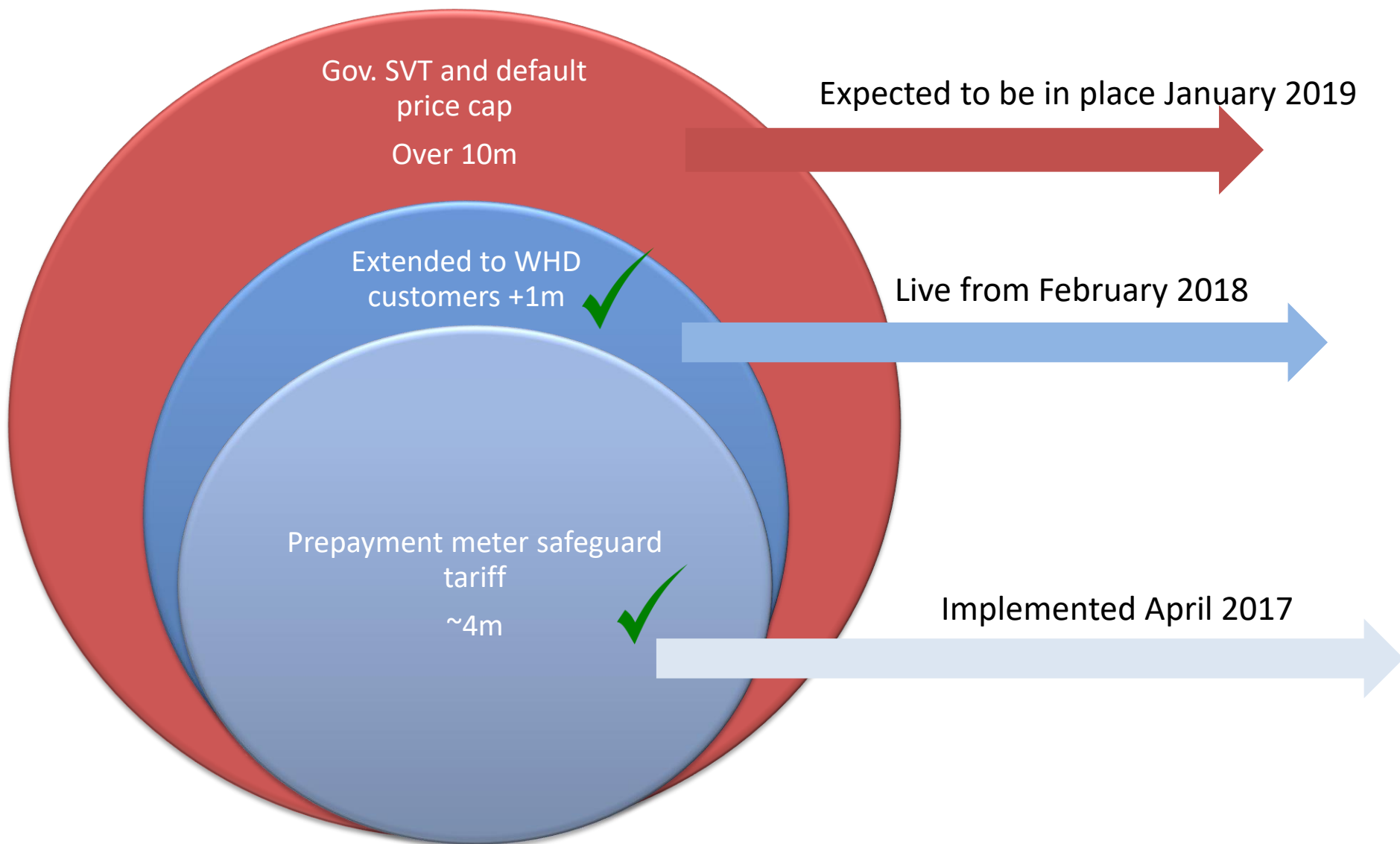
**Disengagement** is significantly **higher** amongst consumers in vulnerable circumstances





**“ Our ambition is a market that works for all consumers, both today and tomorrow.”**

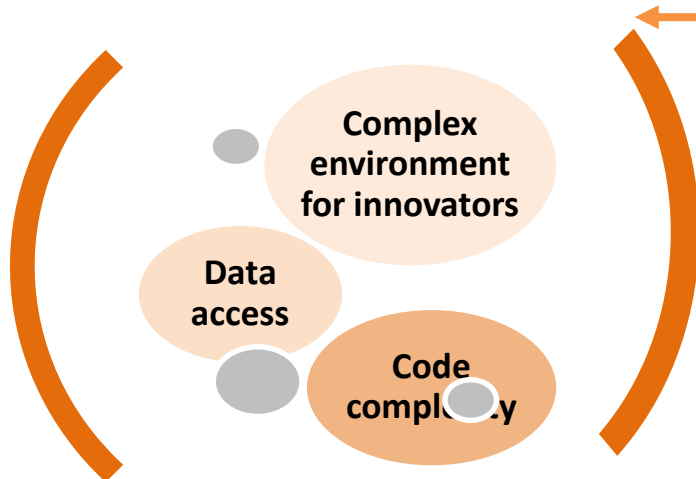
## We are putting in place temporary price protection for consumers



Digital Service  
Assisted Digital Service  
Face to Face support

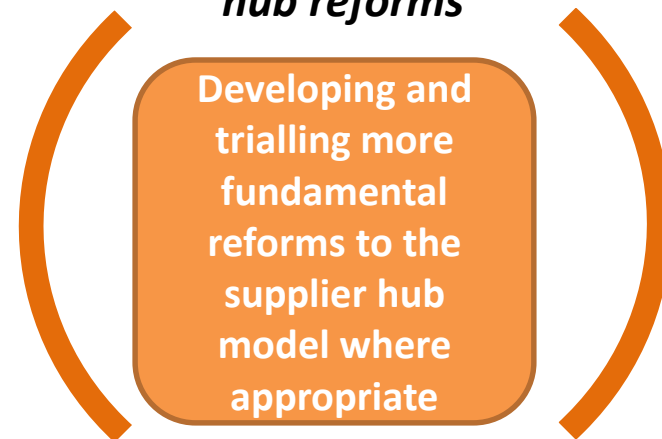
## In the near term we are keen to unlock greater innovation and consumer benefits

### *Near-term actions*



- Enable customer data access
- Improving retail code arrangements
- Enabling more seamless market entry for innovative propositions

### *Longer-term supplier-hub reforms*



Sticky questions we are seeking to answer

- Establishing alternative mechanisms for discharging the Universal Supply Obligation
- How could scheme delivery be simplified to make obligations less onerous / distorting?
- What would the regulatory/ governance framework for competitive service provision look like?

*We need a market model that **encourages new business models and approaches**, in a way that **protects consumers** while also providing for **better default arrangements** for the disengaged.*

**Big opportunity**

to enable and harness the energy transition to deliver better consumer outcomes.

**Need to address persistent problems**

for disengaged and vulnerable consumers.

**Stimulate productivity gains**

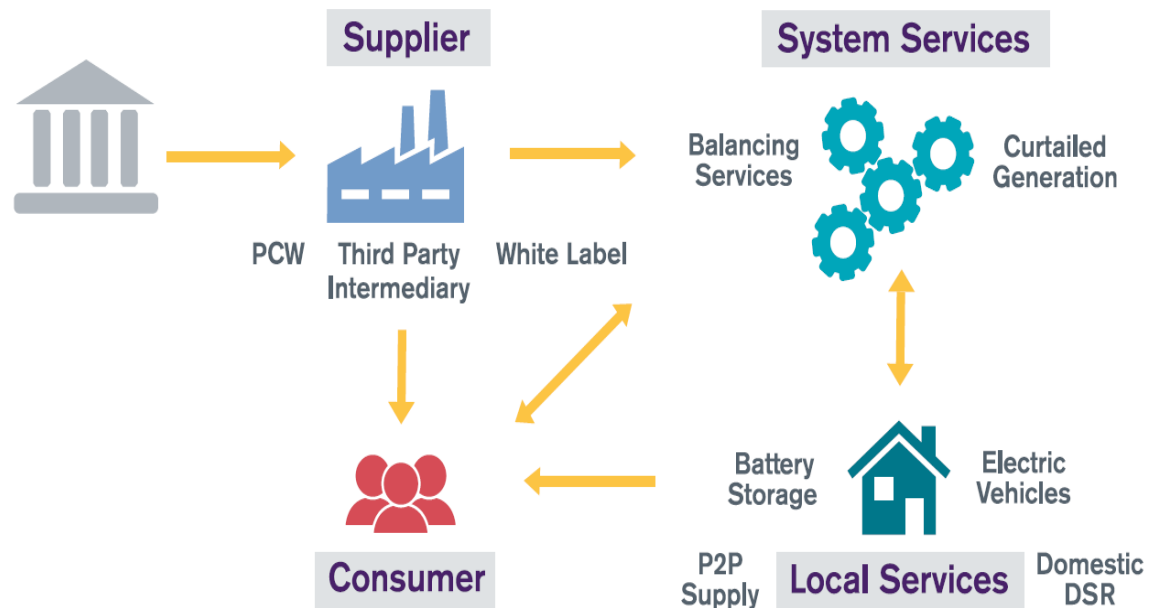
and support for broader UK macroeconomic performance, incl. security of supply.

# Potential role of the consumer in the future energy system

## Traditional

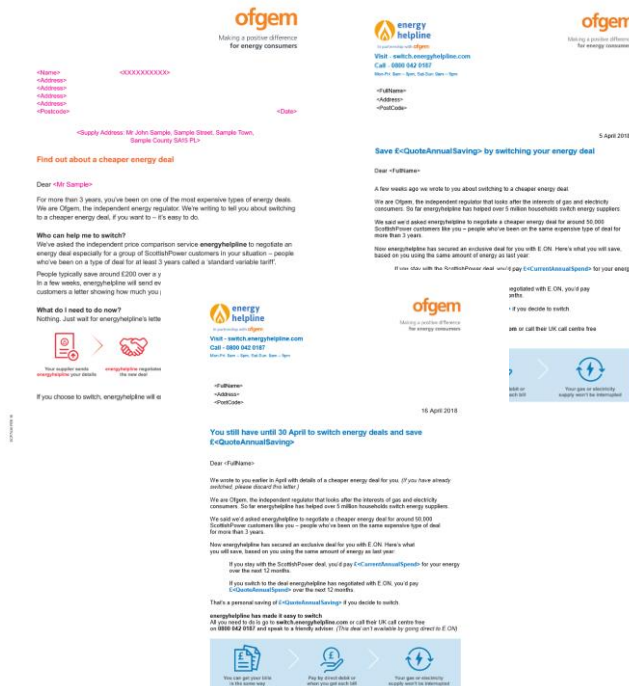


## Future

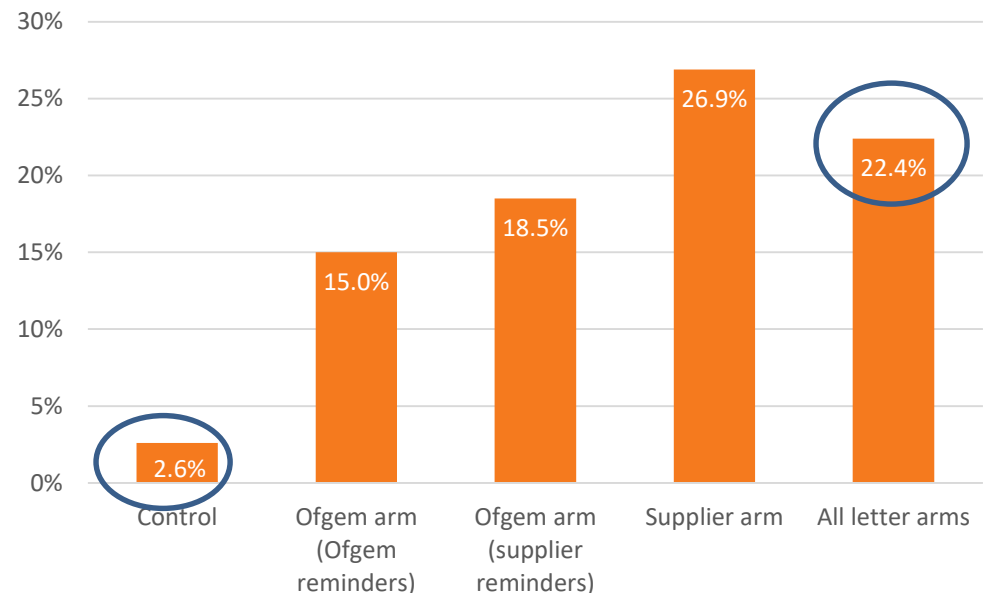


# We are using behavioural insights to understand and test what works in influencing consumer behaviour

- Our trials show that designing behaviourally informed interventions can increase consumer engagement
- Tackling multiple behavioural barriers results in a substantial increase in switching
- E.g. Active Choice Collective switch trial
  - ✓ Series of 3 letters (including a reminder) with priming and repeated messaging
  - ✓ Personalised savings
  - ✓ Trusted consumer partner – to provide end to end hand holding support
  - ✓ Provision of one single collective switch tariff and phone or online switching service removing hassle and making the process easy
  - ✓ Emphasis on exclusive tariff and provision of a deadline to fight against inertia

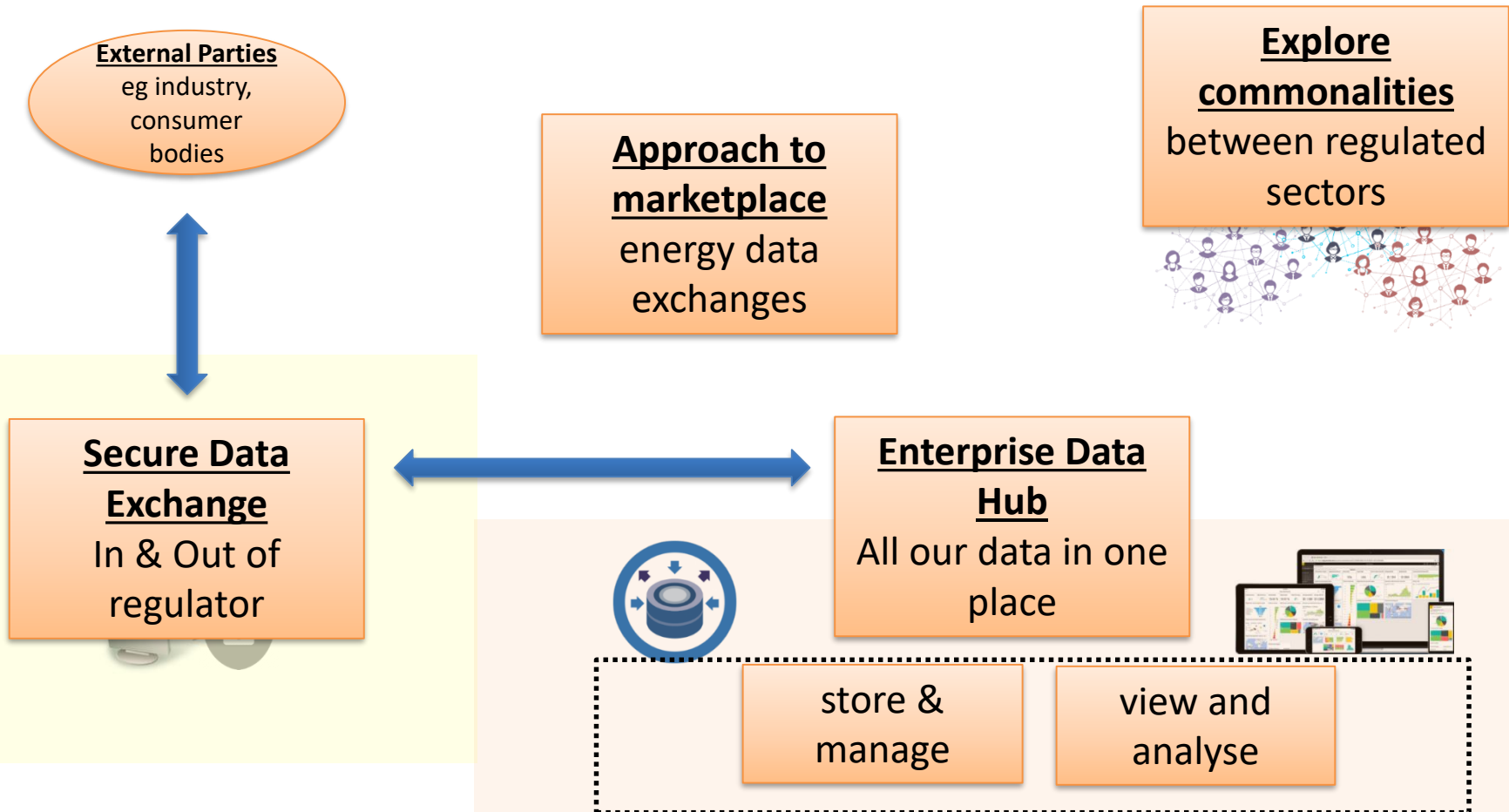


Switching by trial arm



# We are transforming the way we use data inside Ofgem and out in the marketplace

Better use of data will allow us to make better regulatory decisions, ensuring better outcomes for consumers





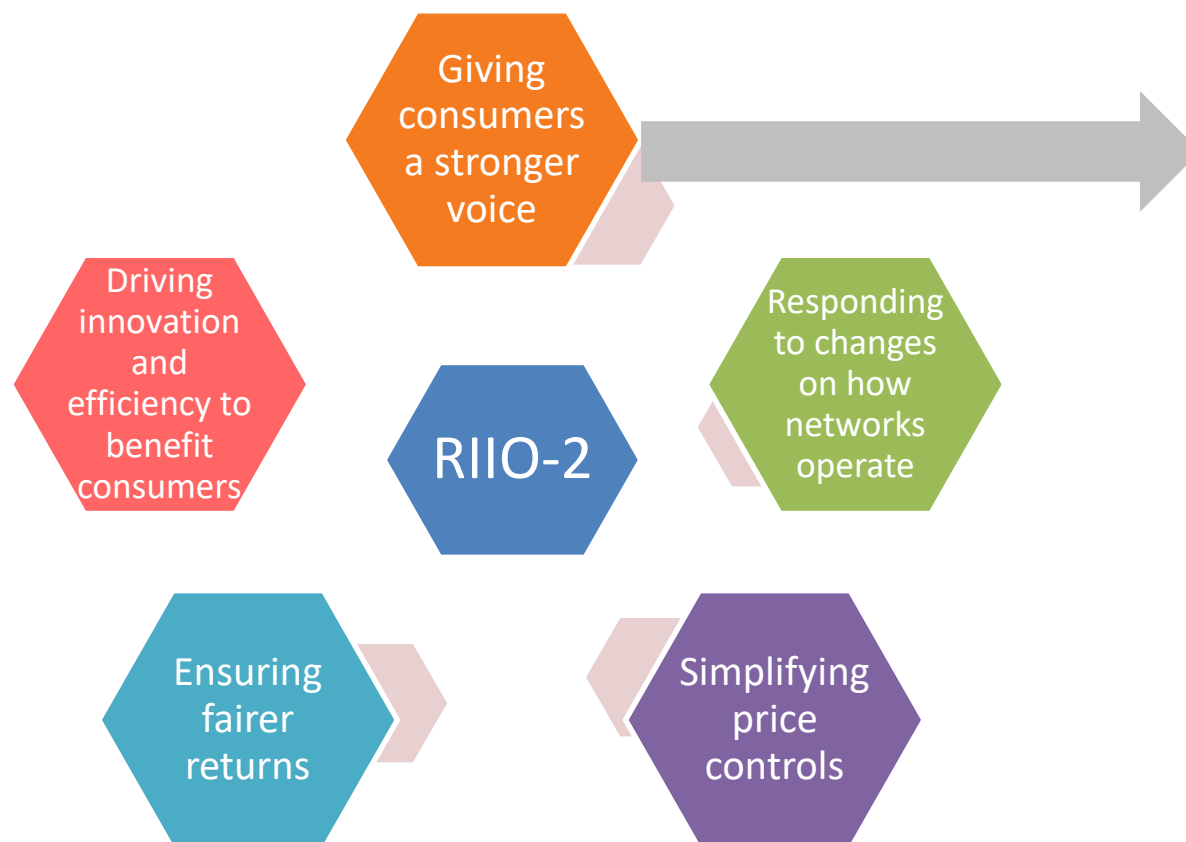
- The landscape for energy consumers is changing rapidly – and regulation must respond
- To protect consumers in the short term, we are introducing a price cap
- To enable consumers to benefit fully from technological innovation, we are considering fundamental reforms to the supplier hub model
- We are also making better use of data and behavioural trials to ensure that our regulatory decisions better account for consumer behaviour

**Our core purpose is to ensure that all consumers can get good value and service from the energy market. In support of this we favour market solutions where practical, incentive regulation for monopolies and an approach that seeks to enable innovation and beneficial change whilst protecting consumers.**

**We will ensure that Ofgem will operate as an efficient organisation, driven by skilled and empowered staff, that will act quickly, predictably and effectively in the consumer interest, based on independent and transparent insight into consumers' experiences and the operation of energy systems and markets.**

**ANNEX**

- Our approach to controlling the prices the network companies charges follows the RIIO model – where **Revenue = Incentives + Innovation + Outputs**
- Insight into stakeholder needs allows companies to deliver the investment and services consumers want, at a price they are willing to pay.



### Approach to enhanced engagement

- Transmission companies to establish a User Group
- Distribution companies establish a Customer Engagement Group
- Ofgem to establish a RIIO-2 Challenge Group

Through our Consumer First programme we have talked to consumers on a number of network and market issues

### **RIO1**

- Understanding consumer understanding of the role of, and priorities for network companies
- Consumer attitudes and prioritisation of outputs under RIO1-ED1
- Consumer needs through reporting on DNO performance

### **RIO2**

- Attitudes towards consumer engagement under the RIO2 process

### **Value of Lost Load**

- Consumer views on risks to GB gas supply continuity and explore options for robustly securing this

### **Approaches to charging**

- Discussions about fairness within the Targeted Charging Review and attitudes towards to Network Access and Forward-looking charges for domestic users

## **We engage with consumers directly through research...**



**tracking surveys help us** understand changes in consumer attitudes and behaviour over time

We run a **Consumer Panel** in which we speak to consumers in locations across GB to seek views on a diverse range of policy issues

We conduct **User research** – to ensure that user needs are at the heart of service design

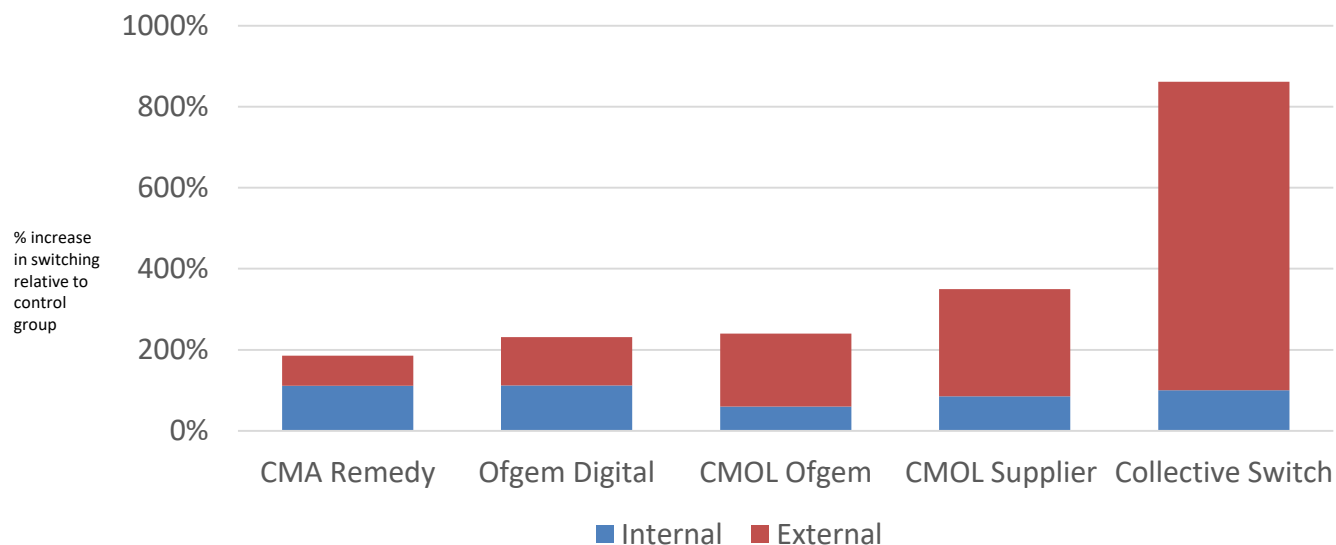


## **We use Behavioural Insight to better understand consumer behaviour and decision making**

- We aim to design policies that ‘go with the grain’ of behaviour
- We test interventions in a ‘real world’ setting using Randomised Controlled Trials



## Relative switching rates by trial



	CMA Remedy	Ofgem Digital	CMOL Ofgem	CMOL Supplier	Collective Switch
<b>Average savings</b>	£131	£293	£213	£216	£298*
<b>Ext/Int switches</b>	40%/60%	52%/48%	75%/25%	75%/25%	88%/12%
<b>Control/Treat switch rates</b>	6.8%/12.5%	2.6%/6.0%	1.0%/2.4%	1.0%/3.4%	2.6%/22.4%
<b>Total sample size</b>	2.4k SVT 3yr+	94.4k SVT 3yr +	150k SVT 1yr +	150k SVT 1yr +	55k SVT 3yr +
<b>Exclusions</b>	All apart from DD dual fuel customers,	Econ 10, special meters	Debt, WHD, S11, NS meters, Special comms, less £20	Debt, WHD, S11, NS meters, Special comms, less £20	S11s, complex meters except E7, smart meters, PPM, WHD, special comms requests except large print

### Barriers to Innovation

- Complexity and volume of codes
- Supply licences are too complex
- Poor access to quality data
- Innovators hampered by generally having to become a supplier or partner with one

### Outcomes for disengaged consumers

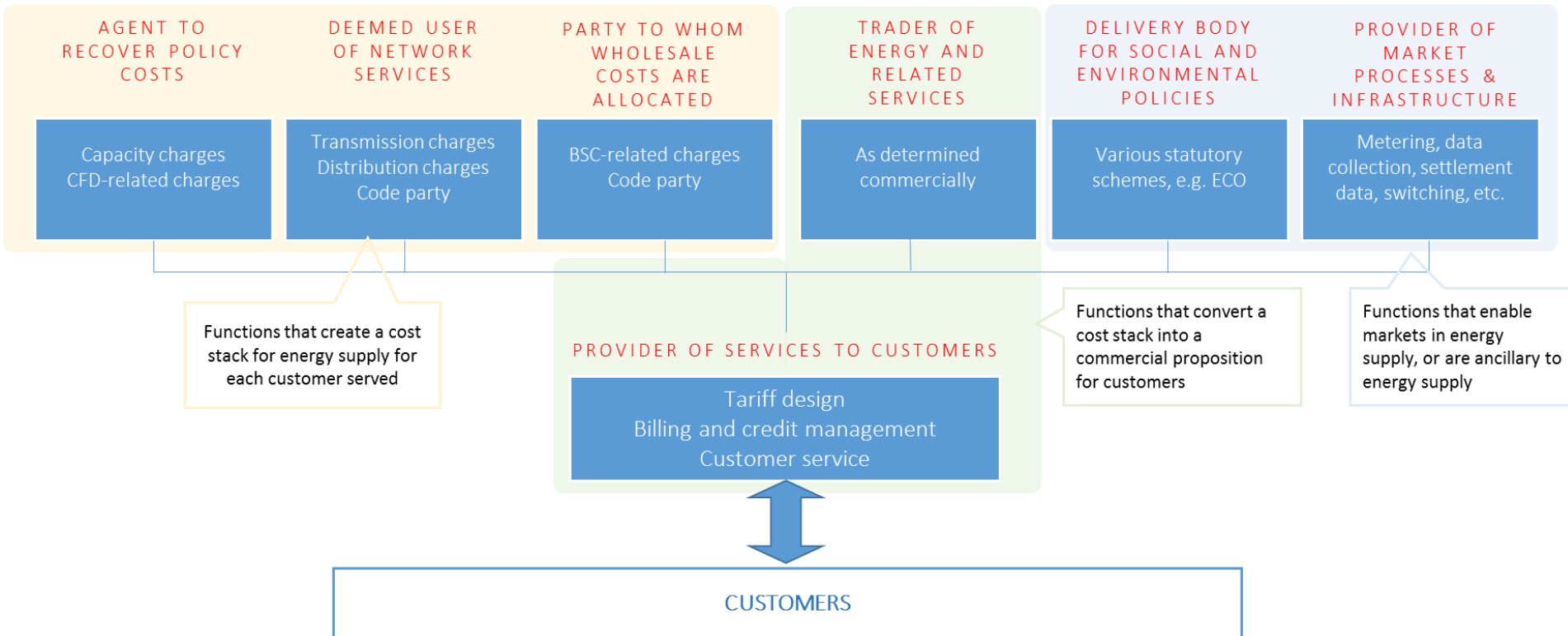
- Desire to focus on prompting greater engagement before further significant market interventions
- Opt-out collective switching seen as disruptive to consumers
- Strong views that consumers must always have access to energy supply

### Risks to consumer protection

- Regulation should focus more on outcomes and services provided
- Need to ensure consumers can easily engage with a more complex market (eg have a 1:1 relationship with their 'supply')
- Emergence of new types of intermediaries and services mean that protections need to evolve so that risks to consumers can be managed in an effective and proportionate way
- Imposition of different rules and obligations on entities providing the same service distorts competition, to the detriment of consumers.



## Supplier hub functions can be unbundled to enable greater innovation



## We commissioned research to explore examples of default arrangements that could be part of a future market model

Option	Features	Implications for GB
1. Separate entity + auction of generation	<b>NEW JERSEY:</b> Licensed entities bid in auction to provide generation to meet default demand. Separate entity provides default tariff and has relationship with customer. Supply costs regulated and charged separately. Default competitive with rest of market. Customers can switch to other supplier if they choose	Separate entity could be the channel to provide 'basic tariff' and would procure energy through auction of generation as in New Jersey. Consumers could choose other energy services from other regulated third parties.
2. Single buyer of generation	<b>ITALY'S AQUIRENTE UNICO:</b> one buyer procures all generation required for default supply. Sells to retailers to supply their disengaged. Supply costs regulated and charged separately. Suppliers compete by offering discount on retail element.	A single buyer could also provide a 'basic default tariff'. It could also sell to retail supply companies to supply their disengaged consumers.
3. Opt-out switches	<b>NO INTERNATIONAL EXAMPLES:</b> but in theory, disengaged invited to <b>opt-out</b> from switch. Could be identified and switched individually or as a group. Does not require action from customer to get better deal.	An opt-out switch could be overlaid even on models with a default supplier. However if 'basic default tariff' is competitive, then reduces need to switch disengaged to secure lower price. Nonetheless, opt-out could switch consumers between basic tariff and other tariffs, as well as to other energy services, depending on consumer preference.
Options tied in with choice of future market model, and involve trade-offs about consumer/supplier relationship, consumer choice, and extent of price regulation		