

Do retail markets work?

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Questions & answers

- Question 1: Do retail markets work?
- Answer: Yes
 - Especially in GB, Norway, Sweden, Texas, Alberta, Victoria, South Australia, NSW, NZ
 - And many other countries for business customers
- Question 2: Why doesn't Ofgem see that?
- Most interesting question 3: how on earth was Ofgem led to its “remedies”??
 - The first “remedy” has already made things worse
 - Second will undermine retail markets completely

Alleged reasons why market doesn't work

- Customers disillusioned with rising prices?
 - Yes – but reflects higher gas prices & costs of govt environmental & energy efficiency policy, not retail
- Energy prices go up faster than down?
 - Evidence mixed – but many markets like this
- Excessive profits?
 - But Ofgem's calcs show low/negative retail margins
- Falling customer switching rates?
 - But still higher than most other retail markets
 - And higher than many other products

Ofgem's real concern?

- Inactive ('sticky') customers pay higher prices than active customers?
 - Yes – but true in all markets
 - That's why customers incur search costs
 - To prevent a return to search activity is to prevent competition, not to make it more effective
- Actual price difference not great
 - Ofgem's charts suggest prices to sticky customers within 10-15% of lowest price in market
 - Sticky customers in fact seem well protected

Non-discrimination condition

- Nonetheless Ofgem decided to prohibit lower prices out-of-area than in-area
 - Standard Licence Condition SLC 25A
 - For three years 2009-2012 plus sunset clause
- Average price differentials have reduced
 - From over £30 to about £13 in Jan 2011 (Ofgem)
- But are customers better off?
 - Have higher prices been reduced? Or lower prices increased? No systematic review of evidence yet, BUT

Impact of SLC 25A

- Economic analysis suggests that higher out-of-area prices is more likely response
- This is consistent with upward path of retail margins since 2009 (per Ofgem)
- SLC 25A has prevented the most effective competition to incumbent suppliers
- Would also explain the reduced switching
- And the increase in temporary offers not covered by SLC 25A
- Also cited as preventing tailored tariffs

Retail Market Review

- Despite finding more equal prices, Ofgem considers SLC25A remedy has not worked
 - Rising retail margins, lower switching, too many offers in the market
 - Join the dots SLC25A has made things worse?
- Still concern that some customers are sticky
- How to make them more willing to switch?
- Ask customers – Ipsos Mori survey

Ofgem's Procrustean Bed

- Customers tell us it is all too complicated
 - “they would be far more likely to engage in market if it is easier to make comparisons between tariffs”
 - Easier to make comparisons with a uniform standing charge and a price comparison metric
- Ofgem's proposal:
 - Suppliers should be allowed only 1 standard tariff (=variable tariff) per payment method
 - All the tariffs to have same standing charge
 - Ofgem to set this standing charge each year

Customer survey

- Customer research has serious limitations
 - Customers faced with artificially difficult problem, $\frac{3}{4}$ say more likely to switch if price guide available - but even simpler price guides **already** available & used
 - Only 6% say they would choose variable tariff - but in reality about 75% choose variable tariff
- So has the interpretation put on it
 - Uniform standing charge is not driving respondents
- This research provides no basis for imposing a uniform standing charge, or for believing that customers would be “far more likely to engage in the market”
 - Cf Oxera’s systematic critique of customer research

Impact on tariff innovations

- Retail competition has led to significant innovations that have benefited customers
 - Option of tariffs with no standing charge
 - Discounts for purchase online
 - Discounts for dual fuel
 - Option of green tariffs of various shades
- Ofgem's proposed uniform tariff would prohibit all these beneficial features
- How consistent with promoting competition and meeting customer preferences?

Other costs & consequences

- Increased costs and risks to suppliers
 - Tariff standing charges beyond supplier control
- And to Ofgem – increased license fees
- Pricing becomes responsibility of regulator
 - Hence more lobbying – rent seeking
 - Annual media event, government involvement
 - Energy pricing once more political, not economic
- Inconsistent with smart metering policy
 - Where number & variety of tariffs should multiply

The way ahead

- Don't reimpose non-discrimination condition
 - SLC 25A the problem, not the solution (stop digging)
- Abandon Procrustean bed
 - It won't work and will undermine competitive market
- Stop grumbling about the retail market
 - That doesn't encourage customers to engage
 - Explore collective switching for vulnerable customers
 - Speed up switching time: from >5 weeks to 2 days
- Improve liquidity by abolishing dual cash-out
- Increase small supplier limit
 - 50,000 to first 250,000 (1% market) for all suppliers