Some issues in the UK retail energy market

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EPRG Conference call

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Outline

- Ancient history
- Modern history
- Competition not affected by tariff cap?
- Impact of tariff cap on
  - Customer switching rate
  - Spread of prices
  - Price differentiation
  - Profits
  - Number of suppliers
- Time to rewrite the narrative?
- And to encourage loyalty rather than disloyalty?
- Latest Overall Customer Satisfaction scores

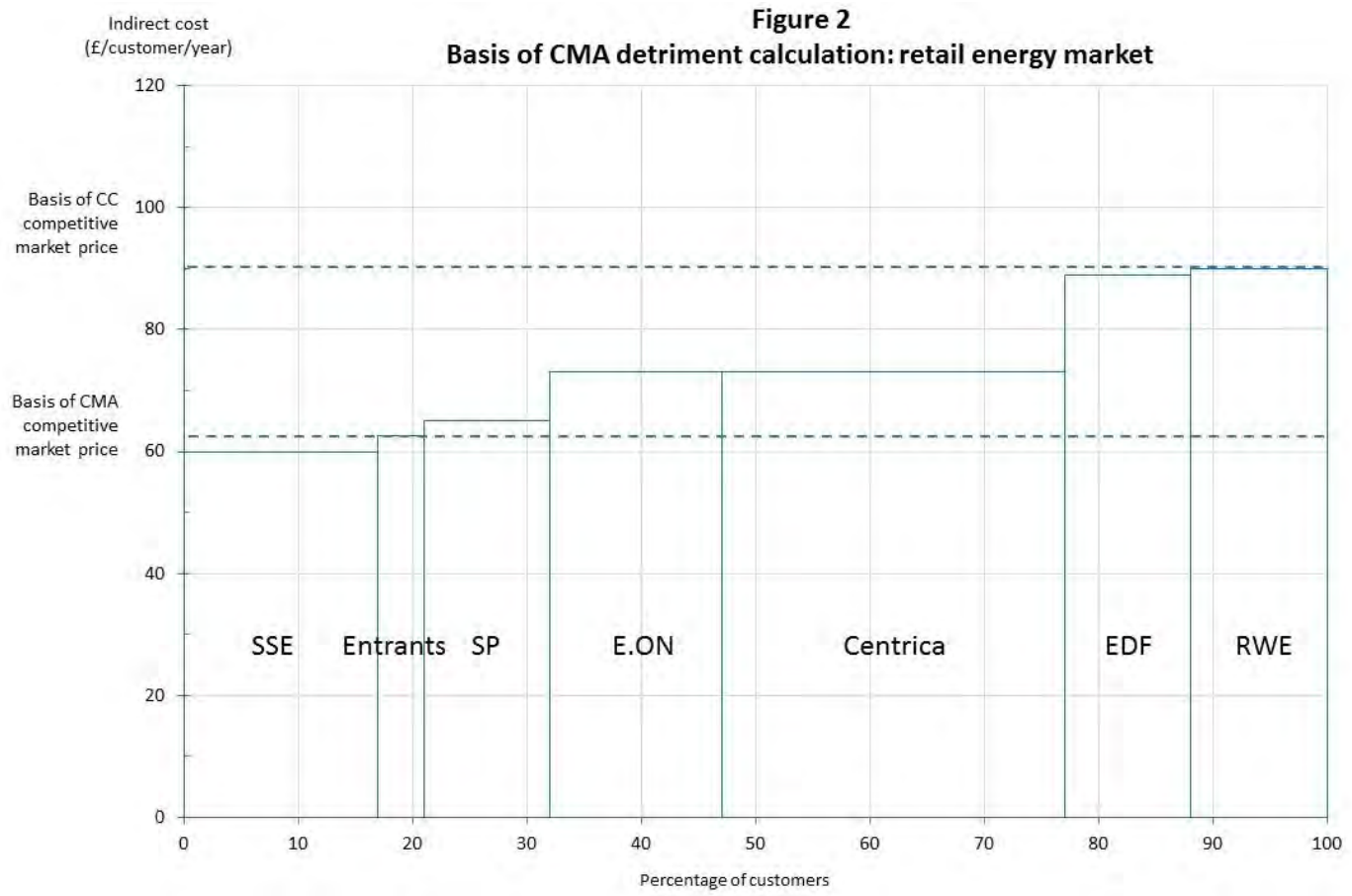
Ancient history

- February 1983 *Regulation of British Telecommunications' Profitability*, London: Department of Industry
- The main argument against RPI-X
- Need to make amends for suggesting a new price control
- How to get benefits of competition in generation to elec customers?
- New entrant Mercury given access to customers via use of BT lines
- Could use same idea for electricity – retail competition
- Nov 1983 Privatisation and monopoly power" M E Beesley & S C Littlechild, paper for Treasury, suggesting this policy
- 1989 Don't need to regulate retail sector, no need for supply licences?

Modern history

- 1990 retail market opened (large industrial customers)
- 1998 retail market open to domestic/residential electricity customers
- 1990 – 2007 Offer/Ofgas/Ofgem promoted retail competition
- 2008 - 2014 Ofgem restricted retail competition
- 2014 – 2016 Issue put to CMA
- 2016 CMA calculates customer detriment of £1.4 - £2bn
  - uses “hypothetical construct” - what the CMA *Guidelines* call “an idealized perfectly competitive market” - which *Guidelines* say will *not* be used as a benchmark
- 2017 calculation featured in June election manifestos
- 2018 Tariff Cap Act
- 2019 Tariff cap in place

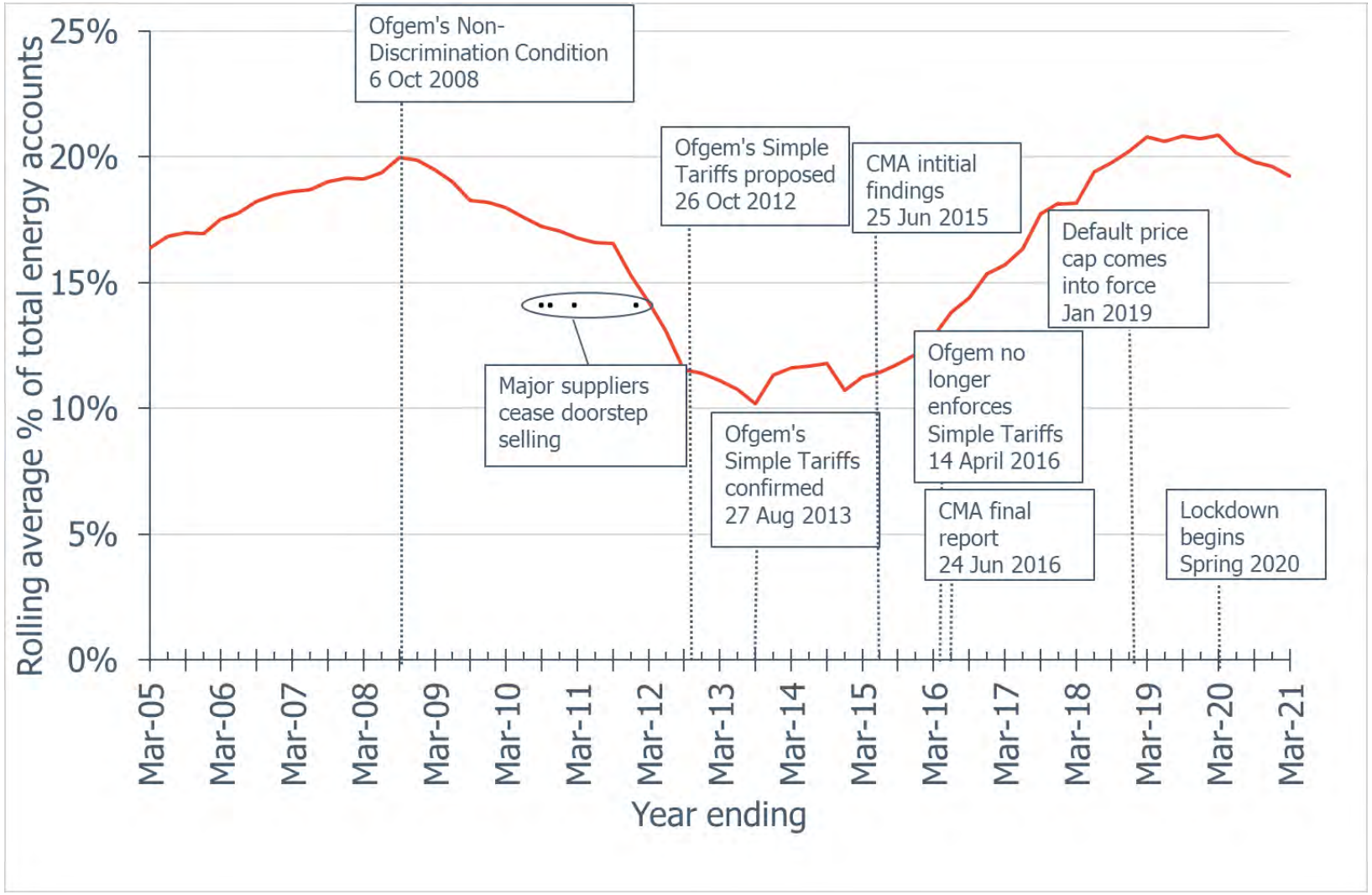
Mistaken CMA detriment calculation



Tariff cap: to remove or not to remove? That is the question

- So the (default) Tariff Cap was all a mistake
  - CMA and Ofgem advised against a cap, dissenting member Prof Cave recommended a short duration “two years or so”, now exceeded
- But the cap has become convenient for Govt and Ofgem
  - Business and Energy Secretary Alok Sharma said: "The energy price cap has been vital in ensuring customers do not pay too much on their bills, which is why we are keeping it in place for at least another year.”
- How then to convince the public that the cap can safely be removed?
- And growing view that it is not so harmful to competition after all
  - E.g. fears of reduced switching & reduced price spreads have not materialised
- So what’s not to like about the tariff cap?
- Let’s check on some of the possible impacts of the tariff cap

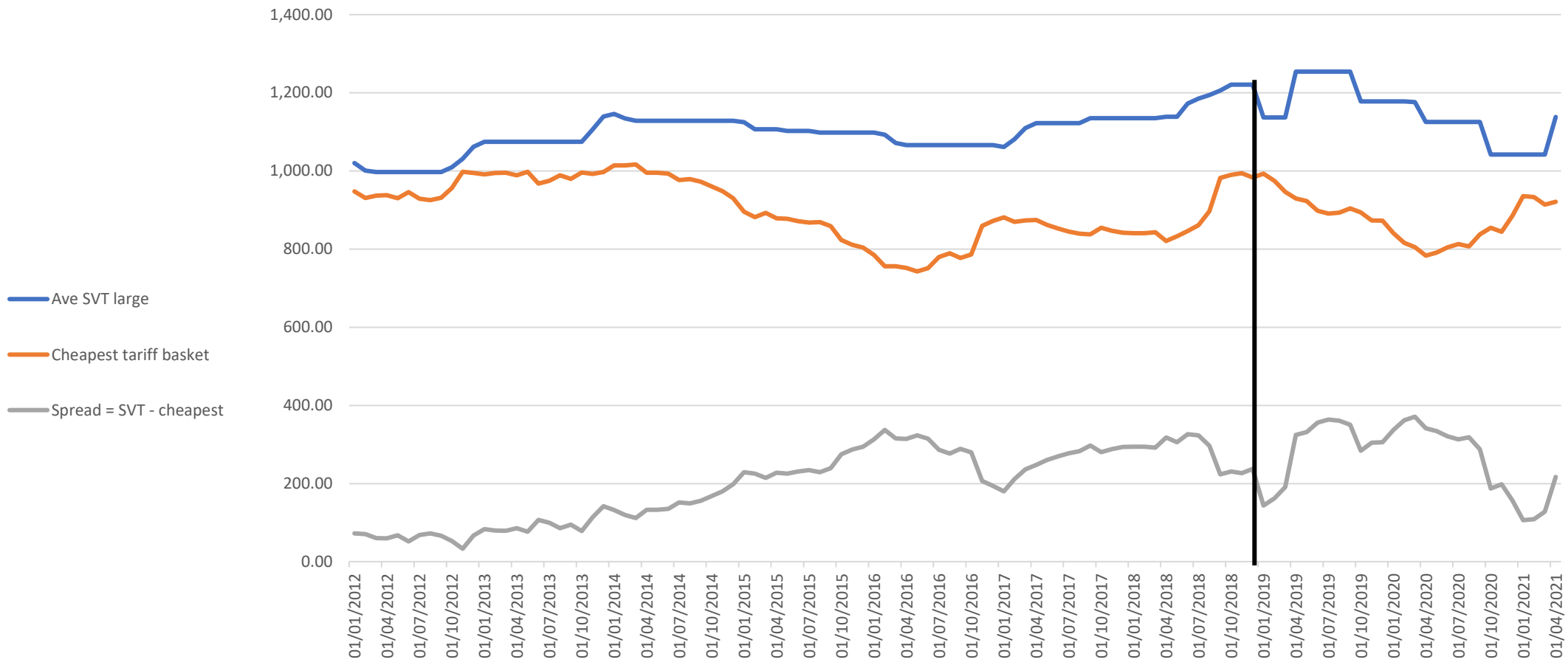
Increase in switching rate checked by cap?



Spread of prices still high so competition not adversely affected by price cap?

- Take Ofgem Cheapest Tariff Basket (CTB) as proxy for wholesale cost
- Define Spread as Ave SVT (large legacy suppliers) less CTB
- Spread of prices initially as high as before, in fact slightly higher
  - Over £320 in only 4 mos 2012 - 2018 but in 12 mos Apr 2019 – Aug 2020
- BUT Spread increases at times of falling wholesale cost, and CTB was falling steadily from Jan 2019 to Apr 2020
- Since then, CTB increased and Spread has fallen
  - £106 Jan 2021 lowest Spread since Oct 2013
  - Oct 2020 - Mar 2021 lowest 6 mos average Spread since Jun-Nov 2014
- So can no longer be argued that spread is high despite tariff cap

Initial wide spread of prices since tariff cap reflects falling wholesale prices, and has since reversed



Tariff differentiation/discrimination: 2 views

- Has the tariff cap helped to reduce unfair price discrimination?
- 1. Reflects ineffective competition, exploiting customers, unfair prices, loyalty penalties; suggested remedies non-discrimination conditions, renewal price = new customer price, tariff cap?
  - CMA, Ofgem, FCA, some consumer bodies
- 2. Reflects effective competition, forcing suppliers to differentiate prices
  - Baumol, most economists
- Compare supplier price differentiation (between SVT & cheapest fixed tariff) before tariff cap (Jan 2018) & after (Nov 2020)
  - Jan 2018 W'sale price £841 & level, spread £294
  - Nov 2020 W'sale price £854 & rising, spread £187
- What prediction? less tariff differentiation? (cap & w'sale market make it less feasible/profitable) or more? (forced by tougher market conditions)

Supplier	Differential (£) 31 January 2018	Differential (£) 02 November 2020	Change in differential (£) 2018 to 2020
8 suppliers reduced large or very large differentials			
Sainsbury's	96	57	-39
Zebra Power	116	66	-50
Shell Energy	215	160	-55
E.ON UK	216	159	-57
Green Network Energy	221	127	-94
M&S Energy	100	2	-99
Together Energy	177	69	-108
ESB Energy	210	24	-186
6 suppliers continued with zero or small differentials			
Affect Energy	0	11	11
Bulb	0	0	0
Igloo Energy	0	0	0
Outfox the Market	0	-10	-10
Utility Point	35	-12	-48
Octopus Energy	-23	29	53
5 suppliers continued or increased medium or large differentials			
OVO Energy	145	143	-2
SSE	56	132	76
British Gas	106	144	38
ScottishPower	73	109	36
EDF Energy	126	141	15
9 suppliers introduced medium or large differentials where none before			
Avro Energy	0	114	114
So Energy	0	86	86
Utility Warehouse	0	77	76
PFP Energy	0	48	48
Pure Planet	0	40	40
Nabuh Energy	0	39	39
Orbit Energy	0	37	37
Green	0	-28	-28
People's	0	-62	-62

Source: Cornwall Insight Domestic Tariff Reports

Size of differential	# suppliers Jan 2018	# suppliers Nov 2020
Very Large > £200	4	0
Large £100-£199	6	9
Medium £31 – £99	4	10
Small £10 - £30	1	6
Zero £0 (- £2)	13	3
Total	28	28

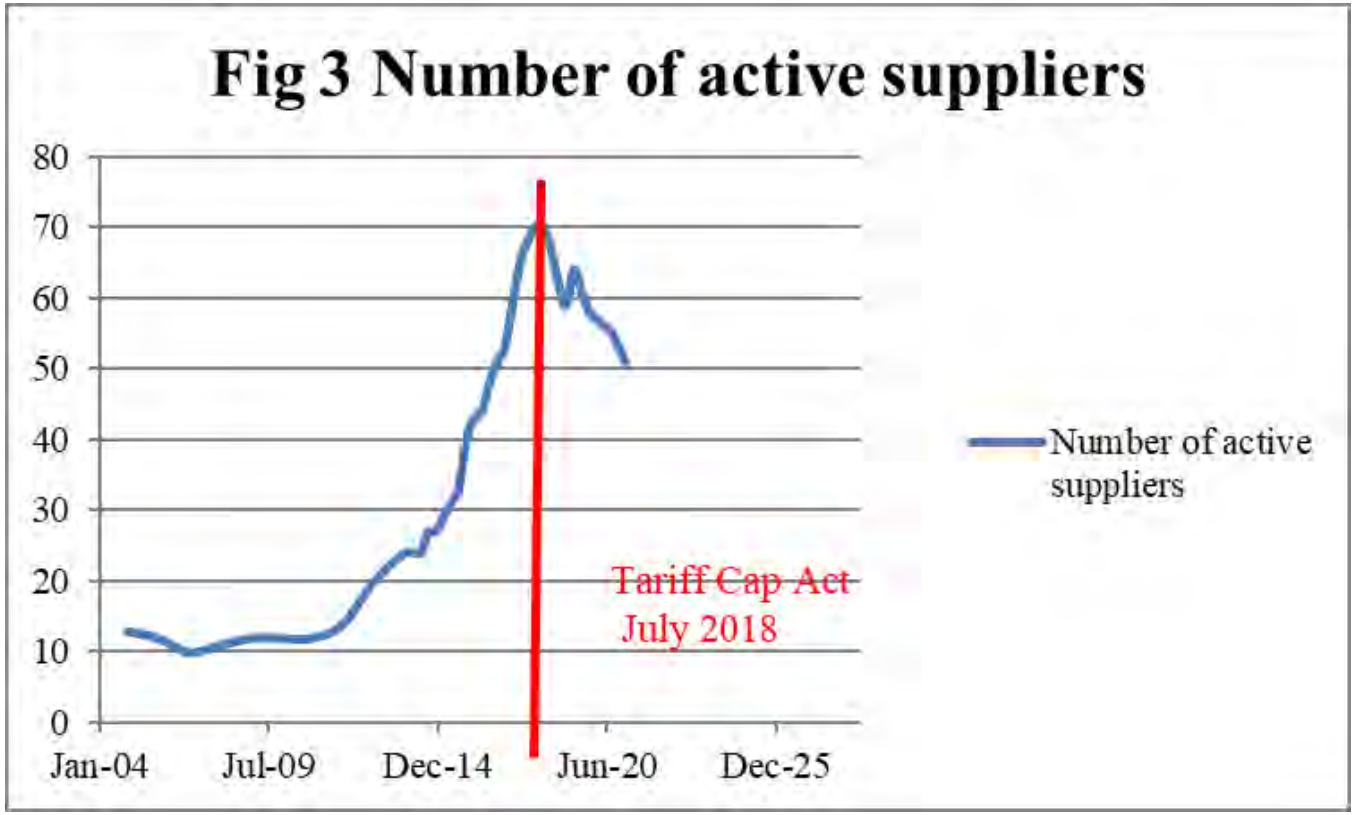
Tariff differentiation: conclusions

- Note just 2 snapshots, conditions changing, smaller suppliers exiting or growing
- So conclusions very tentative, but …
- More tariff differentiation in Nov 2020 than in January 2018, despite tougher market conditions (rising wholesale price and tariff cap)
- More likely *because* of tougher market conditions – competition forces suppliers to differentiate (cf Baumol)
- Tariff cap has not discouraged suppliers from differentiating – if anything it has helped force more suppliers to do it
- So tariff cap not the route to “fair [uniform] prices”, perhaps the opposite
- Single or nearly uniform price for all customers has appeal
- But will it be a viable tactic in the competitive market, including as new suppliers grow? How many such suppliers, and of what size, will customers support? Important questions, but for market, not regulator, to determine

Profits in the retail sector – now losses

- **Six large legacy suppliers**
  - From 2012 to 2017 aggregate average pre-tax profit rate (per Ofgem data portal) moreorless constant at just over 4%. In 2018 it fell below 3% and in 2019 to minus 1.48%.
- **24 other suppliers**
  - Range of net profit margins posted for latest financial year 2019 or later is from minus 1% to minus 29.9%, with mean of minus 10.9% and median of minus 8.1%.
- Losses not surprising because CMA report, and wording of the Act, have led Ofgem in setting the cap to replicate the original CMA mistake re efficient cost and set cap too low.
  - Source 1) Ofgem data portal) 2) mikewhiskeytango.com as of 12 February 2021. This group excludes the six large legacy companies, three renewable energy companies not subject to the cap, and Utility Warehouse (subsidiary of Telecom Plus, a supplier of energy, telecoms and broadband, where the energy sector profit margins are not provided separately from those of the company as a whole).

Entry and now exit in the retail energy sector



Time for a new approach?

- Tariff cap had popular appeal to address apparently serious problem
- But the “problem” was an artefact of an inappropriate calculation
- So the tariff cap was a mistake. But how to remedy?
- Revise cap calculation to phase out cap, to counter fear of sudden price increase
- Explain that tariff cap may appear beneficial but has some adverse effects
  - Re switching rate, spread of prices, tariff differentiation, financial losses & supplier exits
- New investment and new ideas will be important to attain future policy goals: so this market must be attractive to investors as well as to customers
- Explain that this is in fact a competitive market, working to the advantage of customers
- Price differences generally reflect differences in product, quality and reputation, not exploitation of customers
- And getting a good deal does not mean repeatedly having to change supplier

Encouraging loyalty or disloyalty?

- Important to ensure dissatisfied customers can switch supplier, and know that they can, and make switching process swift and painless
- But should Govt/regulator be encouraging switching?
- A switch is a sign of a dissatisfied customer – does it make sense to encourage dissatisfaction, and to measure the competitiveness of the market by the extent of this dissatisfaction?
- Why not, instead, encourage customer loyalty where this is merited?
- Help customers to identify retail suppliers that merit their loyalty

Overall Customer Satisfaction (OCS) score

- The Overall Customer Satisfaction (OCS) score - expressed as a number out of 100 - is calculated as the average of four different ratings of energy suppliers:

- A customer complaints rating based on the complaints reported each quarter by Ofgem, giving a 50% weighting to the number of complaints per 100,000 customers and 25% weightings to the proportions of complaints resolved within 24 hours and 3 months;
- The rating revised each year by the Consumers' Association Which? magazine ;
- The rating revised each quarter by Citizens Advice; and
- The TrustScore assigned by customers recording their views in real time on the consumer site Trustpilot.

- The OCS score does not measure one single aspect of performance. It is intended to be an indication of an energy supplier's ability to provide customer satisfaction across a wide range of metrics, and to be a good supplier according to various different criteria.

- **Latest changes**: Q1 2021 complaints data from Ofgem (27 May 2021) plus updating of TrustScores

- **Pause** to note how assiduous particular suppliers are in making Ofgem complaints data available on their own websites

Availability of quarterly complaints data on supplier own websites (as of 29 May 2021)

Ahead of the curve

- 2021 Q1 plus decimal points: BG, EDF, nPower, SSE, Utility Warehouse, GoTo

On the ball

- 2021 Q1: Shell, Utilita, E, Gulf/HUB, Green,
- 2021 Q1 but incomplete: PFP, Pure Planet

Off the pace

- 2020 Q4: SP, Orbit, Zog

Behind the curve

- 2020 Q3: Eon, Bulb, Ecotricity, Together
- 2020 Q2: Octopus/Co-op, Good, Utility Point

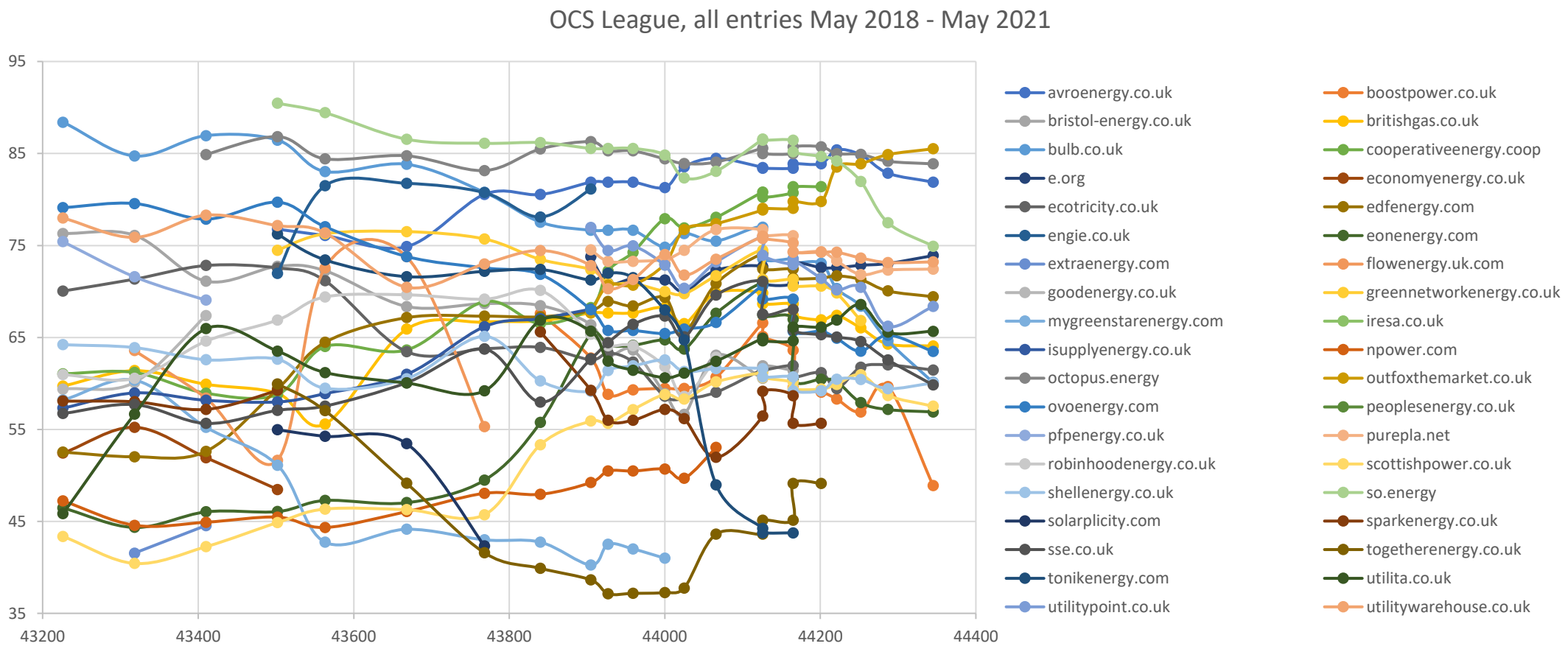
Not serious players

- 2019 Q2: Social
- 2019 Q1: Ovo, Avro
- 2018 (annual?): ESB
- 2016 Q3: Daligas

Not on the spectrum

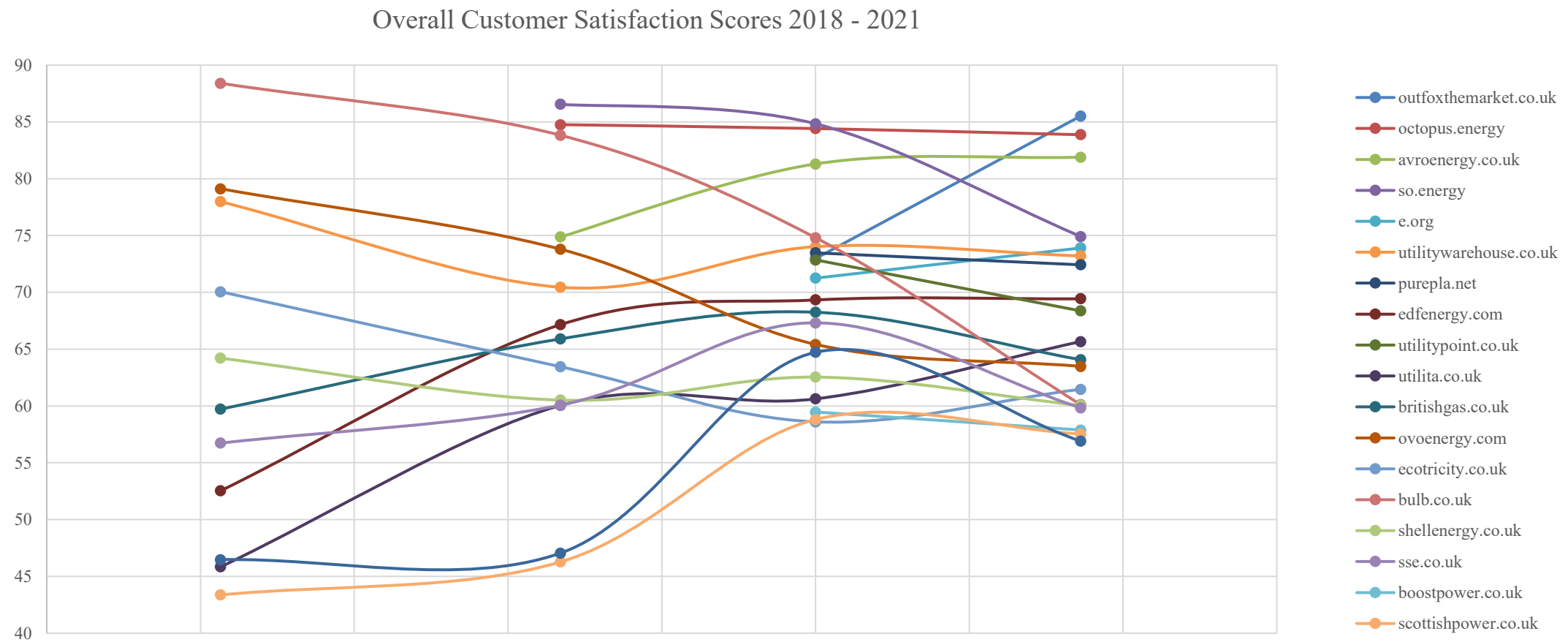
- No information: Entice, Enstroga, Foxglove, Igloo, So, Zebra

Spaghetti anyone?



Overall Customer Satisfaction Score

For those suppliers in the League in May 2021



Concluding thought

- There are good stories to be told about the retail energy market, as well as horror stories
- Maybe the time has come to revise the narrative (and the calculations …)