Trends in domestic energy switching rates

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The CMA's Energy Market Investigation notes that "some [regulations] have been introduced in an attempt to bolster elements of the competitive process". It proposes "to assess the impact on competition of two recent interventions by Ofgem in retail energy markets: the non-discrimination licence condition that was introduced in 2009, and the reforms introduced earlier this year to simplify tariffs". (*Statement of Issues* paras 57, 58)

It is well known that domestic customer switching between suppliers has declined since 2009, as shown in the quarterly DECC statistics reproduced in Figure 1. The *State of the Market Assessment* attributes this to "a variety of factors, including the reduction in doorstep and other outbound sales activity by suppliers". (para 3.16) Research by independent economists has put more weight on the reduction in prospective gains from switching as a result of the Non-Discrimination Condition (SLC 25A).[2] I am not aware of other work that has sought to identify and quantify the different possible effects on customer switching of these factors and other Ofgem interventions that are the subject of the CMA's investigation.

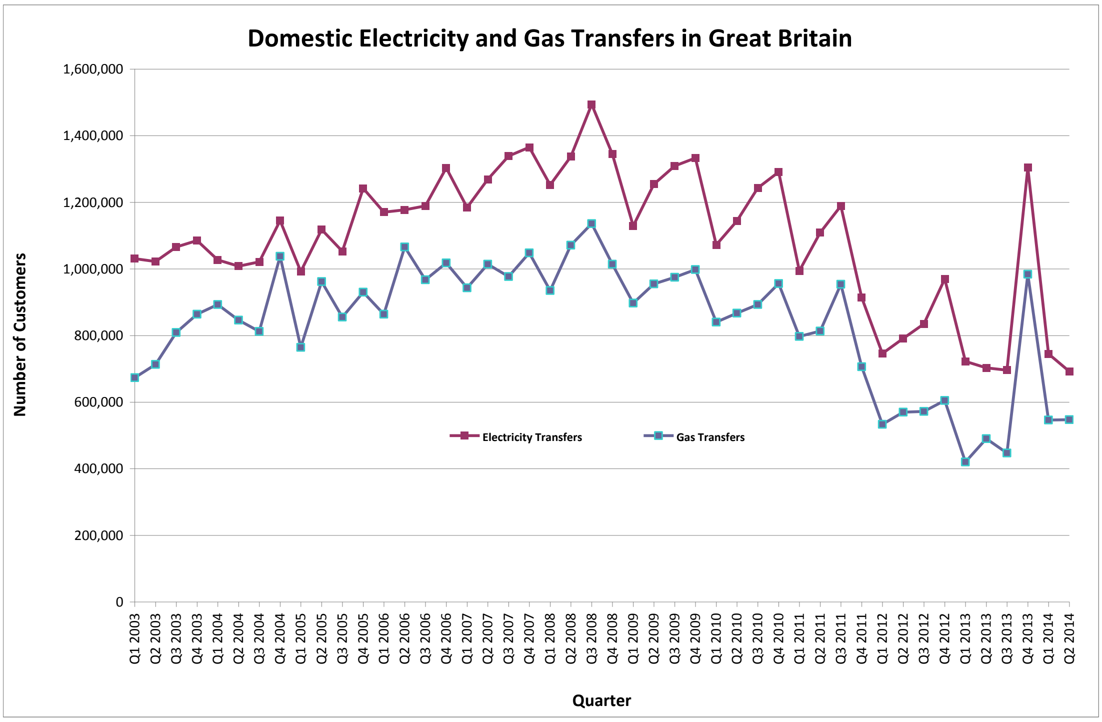

Figure 1 Domestic electricity and gas transfers in GB *(Source DECC Chart 2.7.1)*

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[2] M Hviid and C Waddams Price, "Non-discrimination clauses in the Retail Energy Sector", *The Economic Journal*, Vol 122, August 2012, F236-252. Catherine Waddams Price and Minyan Zhu, "Pricing in the UK Retail Energy Market, 2005 to 2013", Working Paper, ESRC Centre for Competition Policy, University of East Anglia, December 2013, p 15; forthcoming as "Non-discrimination clauses: their effect on GB retail energy prices", *The Energy Journal*, 2015.

It is difficult to assess the raw DECC statistics because total customer numbers are changing, switching for the two fuels sometimes moves in opposite directions, and Figure 1 shows there are significant fluctuations from one quarter to the next.

However, by taking switching as a percentage of total customer numbers, aggregating electricity and gas, and looking at yearly moving averages, we can see more clearly the underlying pattern. Figure 2 shows the Domestic Switching Rate calculated on this basis, expressed as a Rolling Annual Average.

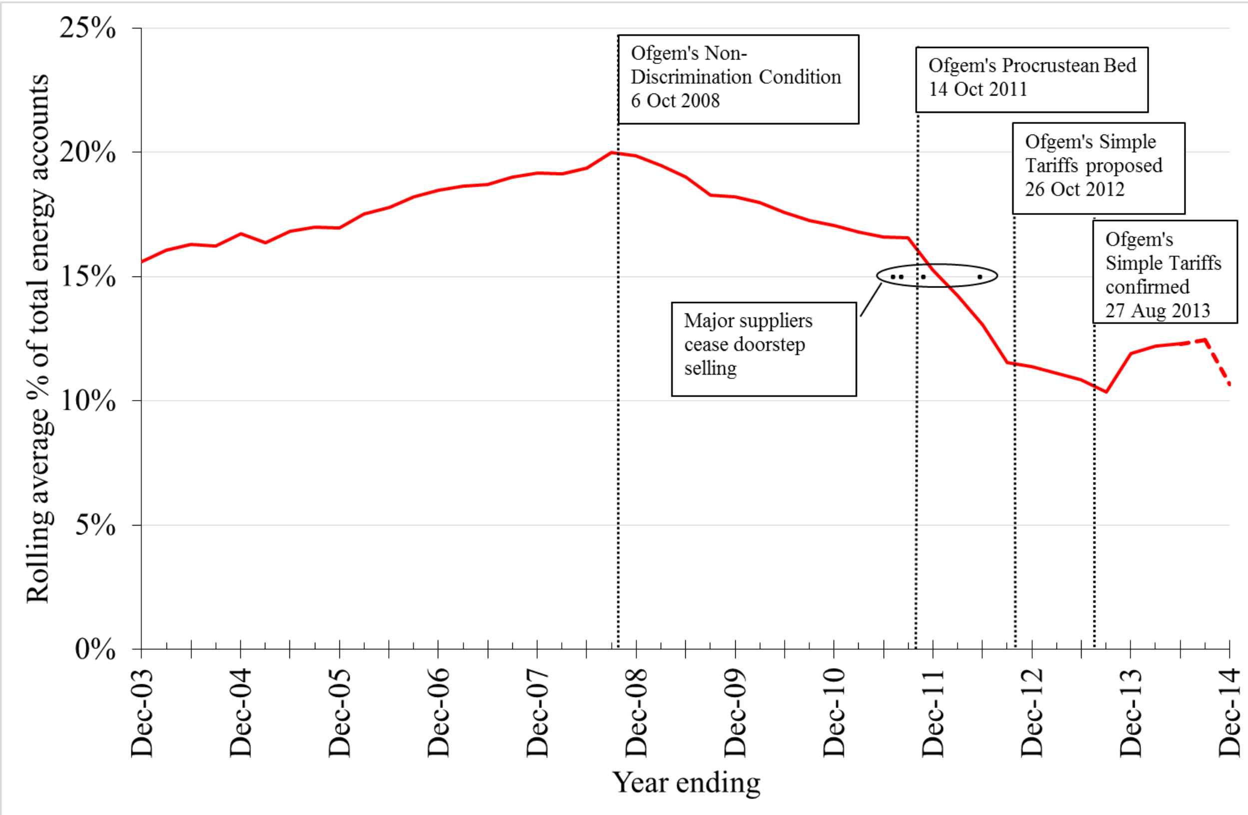

Figure 2: Domestic energy switching: rolling annual averages *(Source DECC Chart 2.7.1 plus a forecast per fn 5 herein).*

It appears that there have been five successive periods since the present Ofgem/DECC database began in 2003. These periods may be associated with successive stages of Ofgem's policy.

Period 1: From the early 2000s to mid-2008, Ofgem did not significantly intervene in the market. The switching rate grew steadily from about 15% to 20% of customer accounts per year. The average switching rate was increasing by about 1 percentage point per year.

Period 2: On 6 October 2008 Ofgem announced its Non-Discrimination Condition. The switching rate reversed direction and declined steadily until mid-2011. The switching rate was now decreasing at about 1 percentage point per year.

Period 3: Between 8 July and 30 November 2011 five of the six major suppliers ceased doorstep selling.[3] This followed increasing public and regulatory pressure.[4] On 14 October 2011 Ofgem

[3] The timings of the announcements and withdrawals were as follows: SSE 8 July 2011, BG/Centrica 12 August 2011, EdF 7 Sept 2011, RWE/Npower 16 October, Scottish Power 21 October (the decisions of the last three suppliers to take effect from 30 November 2011) and E.On 4 July 2012 to take effect after consultation. Evidence was given at the Energy and Climate Change Select Committee Meeting on 11 April 2011 that British Gas "used to have a doorstep sales force of

announced what I have elsewhere called its Procrustean Bed proposal to restrict all suppliers to a tariff with a common standing charge. (It published further details on 1 December 2011.) With this double whammy, the switching rate took an even sharper downturn and declined at a much more rapid rate, about 5 percentage points per year.

Period 4: On 26 October 2012 Ofgem changed tack, abandoning its Procrustean Bed proposal and proposing instead its slightly more moderate Tariff Simplification policy. At the same time Ofgem decided not to renew the Non-Discrimination Condition but warned suppliers not to resume differential pricing. The switching rate reverted to its previous more moderate rate of decline, at about 1 percentage point per year.

Period 5: On 27 August 2013, after various modifications, Ofgem confirmed its intention to proceed with its Tariff Simplification Policy. There was an exceptional increase in switching in November 2013, which the *State of the Market Assessment* suggests "may reflect the recent media and political attention on retail energy prices and their increases over this period since October 2013". (para 3.16) Subsequently, switching has remained at about the earlier 2013 level. (The rolling annual average, still influenced by November 2013, does not yet show this.)

No doubt various possible explanations can be proposed for this pattern of switching, and it is to be hoped that the CMA will explore them. Meanwhile, it would seem that the end of doorstep selling in autumn 2011 did have an adverse impact on the switching rate, insofar as it helped to accelerate a reduction that had already been underway for three years as a result of the Non-Discrimination Condition.

On the face of it, poor Ofgem seems to have had an unerring reverse-Midas touch with respect to retail regulation. Every time it has proposed to intervene to improve competition it has reduced rather than increased switching. The more significantly it has proposed to intervene, the more adverse effect it has had. After some five years of regulatory intervention to encourage customer engagement, the customer switching rate had declined to about 10% in late 2013, just half what it was in late 2008 when the new policy was started. In fact, unless there is another exceptional increase in switching in last quarter 2014, the yearly average reported switching rate will be slightly lower in 2014 than it was in 2012 and 2013.[5] An assumption underlying Ofgem's policy evaluation is looking a little vulnerable.[6] And this despite the significant entry of new suppliers offering substantial discounts, that one might normally have expected to increase the switching rate.

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around 1,200. Today it is only 300", and that E.On "did actually reduce massively" its door-to-door sales force a few years earlier. I understand that other suppliers stopped more abruptly.

[4] For example, on 23 April 2008 Ofgem began an investigation of alleged misselling by Npower, and on 30 January 2009 announced a fine of £1.8m. On 27 April 2010 Ofgem introduced stronger guidance on direct sales and marketing activities. On 2 September 2010 Ofgem opened an investigation into the sales practices of four of the six major suppliers. Surrey County Council Trading Standards Department prosecuted SSE for misleading selling practices, and on 10 May 2011 SSE was found guilty on two counts. On 11 May 2011 Barry Gardiner MP, a member of the Energy and Climate Change Select Committee, began a campaign to persuade the suppliers to end doorstep selling.

[5] Figure 2 shows the yearly average switching rate to quarter ending June 2014 based on DECC switching figures and Cornwall Energy data for total number of customer accounts. The forecast to quarter ending September 2014 uses electricity switches as reported by Energy UK and gas switches based on DECC data in the previous three quarters. The forecast to December 2014 assumes that the same proportion (28%) of switches occur in the last quarter of 2014 as occurred on the average over the previous years 2003 to 2013. On this basis, the forecast total number of energy switches for 2014 is 5.3m against 5.6m in 2012 and 5.9m in 2013.

[6] "We do not consider decreased engagement as a result of RMR a realistic possibility." Ofgem, *The Retail Market Review – Final Impact Assessment for domestic proposals*, Ref 41/13, 27 March 2013, para 3.153.

How exactly the impact of policy has worked deserves further exploration. It would seem helpful to make comparisons with switching in other sectors like telecoms and banking. It may be that expected as well as actual restrictions are in play. Thus, an unexpected announcement of a more interventionist regulatory policy may lead the major suppliers to draw in their horns and keep their heads down: that is, to pause the marketing of existing products and to begin to adjust the product range to the latest regulatory preferences. The more severe and unexpected the proposed change in policy, the more cautious is the reaction of the suppliers, and the more muted their attempts to persuade customers to switch. Conversely, an indication of less intervention and greater regulatory stability encourages suppliers to devote more resources to persuading customers to switch.

Hopefully the CMA will shed more light on the determinants of customer switching in the energy sector. This all bears on the central issue of whether customer engagement and switching are primarily driven by simplicity of tariffs, as Ofgem maintains, or by prospective gain, as economic analysis and empirical evidence suggest. It seems that supplier expectations and ability to reach potential customers may also be contributory factors.