ENERGY MARKET INVESTIGATION

Summary of hearing with the Federation of Small Businesses on 16 December 2014

Background

1. The Federation of Small Businesses (FSB) was the United Kingdom's (UK) largest campaigning pressure group that promoted and protected the interests of the self-employed and owners of small firms. It had around 200,000 members, across 197 branches in 36 regions, and the vast majority of the organisations it represented were small or micro-businesses, though some of its members did employ up to 250 people.

2. FSB conducted regular surveys among its members to identify their concerns, and in 2014 FSB had conducted a survey among its membership to ascertain their views on the energy market. The findings showed that many small businesses believed their needs were ignored by energy retailers.

3. The FSB had a good working relationship with Ofgem and believed Ofgem had become more sensitive to the concerns that FSB had raised about the issues that affected its members.

The energy market

4. FSB said that its members found it difficult to compare prices of energy products and did not understand the products, their cost and the terms and conditions under which they were offered. It was important that this lack of clarity was rectified to enable the market to function effectively.

5. The majority of FSB's members were small companies whose energy consumption was similar to domestic consumers. The opportunity cost of negotiating an energy contract was very large for a small company and it was not always certain that a company would achieve the best deal through negotiations. FSB was aware that at the end of a time-consuming negotiation process, suppliers had requested a large deposit before supply would commence, which was unclear at the start of the process.

6. Energy products did not offer the same level of price transparency compared to other items a small business purchased. Small businesses preferred to

have a number of published tariffs from which they could choose and did not want to engage in lengthy negotiations when their energy usage was very low.

7. FSB said that its members would like fixed-tariff contracts, but none were available. FSB also wanted its members to have the same level of protection afforded to domestic customers, particularly around disconnections and the transparency and comparability of pricing. A set of published tariffs would bring transparency to the market and help rebuild trust.

8. Business rates and access to finance were key concerns raised by FSB's members. FSB's recent energy survey had highlighted that one in three of its members viewed energy costs as a barrier to growth and success, and only 25% of respondents believed there was enough competition in the energy market. Recent energy price increases and media coverage over security of supply also heightened its members' concerns.

9. An enormous diversity existed among FSB's members. Those based in remote areas, who were not connected to the gas grid, particularly struggled and were proportionately more disadvantaged as energy prices increased. The vulnerability of particular businesses to rising energy prices had been raised with both Ofgem and suppliers.

10. Around 10% of FSB's members had an arrangement where their energy costs were included in their rent, which meant that they had little control of or interest in energy costs.

11. Despite suppliers' claims, FSB had not been provided with evidence to support the contention that small businesses posed a significantly greater credit risk than domestic consumers. It argued that this data would provide a welcome basis for future policy planning.

Switching

12. FSB's energy survey had identified low levels of switching among its members, who believed switching would not achieve better value for money or lead to an improved service. A lack of trust regarding suppliers had led small businesses to disengage from the energy market.

13. Of those that did respond to the energy survey, around 50% said they had recently switched or were considering switching, which FSB thought was quite high. Half of those who had switched said it had a positive impact on their business, which, again, was higher than FSB expected.

14. Of those survey respondents who said they have not recently switched supplier, only one in three said it was because they were satisfied with their

current energy deal. One in four of these respondents said the switching process involved too much ‘hassle’.

15. The lack of options available to its members had led FSB to seek a partnership with an energy supplier, through which it could offer the energy services and level of performance that its members required.

16. FSB had a member services division that negotiated affinity deals for its members in a number of sectors, including finance, leasing and retail. These were offered on very favourable terms and FSB hope to do something similar with energy.

17. FSB hoped to go into the marketplace with its proposal in 2015 and believed there would be significant uptake among its members of the new service. It had yet to decide whether the service would be available to members only or a wider audience.

18. Acquisition and switching costs were high for suppliers. If micro-businesses were convinced that they would receive a reliable and value for money service, this could encourage them to sign up for two-, three- or four-year contracts.

19. Conversations with energy retailers had led FSB to believe that this would be welcomed by suppliers, who, rather than have uncertain levels of profitability, would accept a lower, but sustained level of profit. One element in achieving this was the eradication of customer acquisition and switching costs.

Micro-businesses

20. FSB did not make a distinction between the interests of micro-businesses and its larger members. The Small Business, Enterprise and Employment Bill that was currently being considered by Parliament defined micro-businesses as having less than ten employees. FSB used the term ‘micro-business’ as it was a category for which Ofgem had created special licence conditions.

21. FSB believed that the smaller the business, the less it engaged with the energy market. A lot of micro-businesses were sole traders, who did not have the time or resources to look for the best energy deal and could be taken advantage of by suppliers.

22. The median energy rate for FSB’s members was in the range of 11 to 12 pence per kilowatt hour. This went down to 10 pence in some cases and up to 15 pence in others. The 15 pence rate accounted for those who had not renewed their contract and were ‘rolled-over’ onto a new contract which was usually more expensive.

23. The use of auto-rollovers was a key concern for FSB and it was pleased that many suppliers had voluntarily stopped using them. FSB still had serious concerns regarding the absence of communication between suppliers and business customers when energy contracts were coming to an end and the disproportionate cost of the contracts businesses were moved to compared with their previous contracts.

24. Some of FSB's members were comfortable with auto-rollovers as they were happy with the financial implications and found it a convenient route into a new contract. But it was important that businesses understood the rate they would move to when they did not renew their contract and that this was transparent, enabling comparisons to be made against alternative tariffs if they wished to move.

25. FSB's members had highlighted that communications received from suppliers did not always clearly set out the new rate they would be moved to if they did not renew their contract. The details were often buried in small print, making it difficult to identify the new tariff, which was likely to be at a higher rate. FSB was aware that Ofgem was looking that this issue.

26. The majority of FSB's members currently paid ten or 11 pence per kilowatt hour. FSB hoped that if suppliers offered and published set tariffs, the prices would remain at these levels and that suppliers that offered tariffs at a higher price would lose market share.

27. FSB would like to see suppliers offer a 'one-size-fits-all' tariff for its members. For those companies that had a good credit record, and who would seek a better deal, FSB hoped that the market would develop to enable them to negotiate a better price.

28. The smaller micro-businesses did not really understand the energy market, were not particularly engaged and therefore did not trust it. The lack of comparability and the lack of transparency reinforced that lack of trust, and unlike the domestic market, there did not exist a plethora of comparison websites for business customers.

29. FSB believed that trust was a two-way issue and would be built through openness and honesty and by parties delivering what they had promised. Many small businesses believed that energy companies were not delivering what was expected in terms of supply, price, openness and communication. The criticism that energy companies received in the media was not always justified, but there was a failure on their part with regard to communications and estimated bills and these were among a catalogue of issues that had eroded trust among small businesses.

30. FSB believed energy companies had made the relatively simple exercise of supplying energy far too complex and there did not appear much activity from suppliers, including new entrants, to rebuild trust.

Third-party intermediaries

31. FSB believed that the majority of its members did not use third-party intermediaries (TPIs) when seeking an energy contract. Lack of trust, lack of transparency and lack of confidence were cited as reasons for not using TPIs. Those that did use TPIs were relatively satisfied with the service.

32. FSB's members did not understand the TPI market because, in the same way that the energy prices were not transparent, the services and prices negotiated by the TPIs were not transparent, including whether TPIs earned fixed fees or received commissions. It was also unclear whether TPIs targeted all of FSBs members or went after the larger businesses, ignoring the smaller entities.

33. FSB's energy survey had shown that the average spend of its members on energy was less than £5,000. It appeared that TPIs were not interested in companies with an annual energy spend of less than £5,000 and targeted companies spending over £5,000 to increase their margins.

34. FSB said that TPIs hoped to achieve margins of between 5% and 20% when brokering energy contracts. Many member-based organisations organised collective switching exercises for their members and if such margins were achieved, both the organisations and its members would benefit financially.

35. From talking to energy suppliers, FSB said that acquisition costs for suppliers were anywhere from £80 to £200. If this acquisition cost could be removed, it could be discounted from the price of the energy contract. If there was some certainty that a large number of businesses would switch, FSB believed that switchers would secure better prices and TPIs make significant margins.

36. FSB was aware that organisations such as the British Chambers of Commerce and the Association of Convenience Stores had used brokers to organise collective switches for their members.

37. Ofgem was developing a code of practice for the TPIs and FSB had participated in the consultation process.

Energy efficiency measures

38. Over the past two years, FSB had pushed a number of energy retailers to improve their performance regarding energy efficiency. Most suppliers were now aware that added value services in the energy efficiency sector were not only a way of not only securing customers, but also retaining customers.

39. FSB said its members switched supplier to save money, but some were now very concerned to reduce their energy consumption. Energy efficiency was not part of a supplier's license conditions and there was no incentive or requirement for energy companies to deliver energy efficiency services.

40. There was a disconnect in the energy market between encouraging businesses to switch, which may have a minor impact on costs, and supporting energy efficiency, which may have a greater impact on costs.

41. The affinity deal that FSB proposed would have an element that promoted energy efficiency. FSB also believed that if businesses entered into fixed-term contracts, this could enable energy suppliers to divert funds currently spent on acquisition and switching to support energy efficient measures.

Smart meters

42. FSB was disappointed by both the design of the smart meter roll-out programme and the progress made to date with regard to small and micro-businesses. FSB saw smart meters as a key component of empowering FSB's members to reduce energy consumption and develop a better understanding of the energy market.

43. FSB was in discussions with the smart meter delivery body and DECC about the failings of the roll-out. There was no engagement plan for small and micro-businesses; the focus was on the domestic sector. There was no uniformity in the way in which smart meters would be used and the way in which consumers would receive usage data, though this would be standardised for domestic customers. FSB was unsure whether suppliers' products could be compared given this lack of standardisation for business customers.

44. FSB believed DECC appeared reasonably relaxed that the market would innovate and cross-fertilisation would emerge between different platforms, enabling interoperability. DECC had said that technology developed for domestic customers that was suitable for the micro-business sector should be used by suppliers.

45. There were too many uncertainties for FSB and it was not convinced that if a business wanted to switch to another supplier, it would be in a position to provide historical usage to a new supplier.

46. FSB also identified a lack of transparency regarding costs for smart meters as an issue, particularly the lack of transparency in monitoring costs. The installation code of practice was now in place, but FSB was not convinced that it was robust enough. It appeared that if a firm was unavailable to receive installation of a smart meter, it would have to keep the meter it currently had.

47. There was a lack of support for the use and maintenance of smart meters and supplier were focused on efficient, effective, cheap installation of a smart meter, with no-one responsible for the software and how it was used.

48. Smart meters were viewed as a good thing by FSB's members, but the roll-out programme left a great deal to be desired. If smart meters merely gave accurate prices, this was a very expensive way of doing this.

Concluding remarks

49. FSB was concerned about access to the grid for connecting micro-generation and the lack of transparency in the connection charges, particularly the way in which they were structured. For those who would like to invest in generation and distributive generation, the cost unreasonably fell upon those who want to engage in generation, an activity that would reinforce the grid.

50. Many of FSB's members would like to invest in micro-generation and sell energy, but were unable to do so because of the excessive cost of connecting to the grid. FSB was aware of a small business in north Northumberland that was going to purchase a small wind turbine for £36,000, but the grid connection would cost another £36,000, which was not financially viable.

51. The ability to generate their own power would improve the viability of many rural businesses. Such undertakings could be as large as 50 kilowatt small solar arrays, but the grid was so frail in many rural areas that it was unable to even accommodate this.

52. FSB was concerned that its members in Northern Ireland felt significantly disadvantaged by the absence and failure of competition in the region. The FSB hoped that the CMA's investigation would look at the energy market in Northern Ireland.