

Competition and Markets Authority: Energy market investigation

Response to provisional findings

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Jon Bird, PhD, FEI

Associate, Sustainability First

Summary

The CMA appears not to have considered risk aversion by domestic customers as a possible reason for the lack of switching.

Argument

1. The CMA provisional findings identified weak customer response and lack of engagement as an area where domestic retail energy markets may not be working well for customers. The CMA's survey results suggested that there may be a higher proportion of disengaged customers amongst those with low incomes and low levels of education, although disengagement was also the case for the majority of other customers.
2. The implication of this finding appears to be that the CMA considers poor understanding of the benefits of switching to be a significant reason for the lack of engagement. This reasoning fails to recognise that there could be a wholly rational reason for the lack of switching once risk is taken into account, a factor ignored in the provisional findings.
3. Paragraph 98 of the summary of the provisional findings makes clear that, although the Standard Variable Tariff (SVT) can in principle be changed by the supplier at any time, in practice SVT prices have generally changed only once or twice a year. (This is linked historically to the frequency of meter readings – any more frequent price changes would require complex estimation of usage.) However, there is no fixed date for a change to the SVT and different suppliers will change their rates on different dates, usually following fairly closely on the first supplier to change price, but not necessarily the same supplier taking the lead each time. In this respect, the pattern and sequence of price changes is very similar to that in the retail petrol and diesel market. However, unless an energy user assiduously follows media stories about changes to energy prices, he/she will not be aware at any time whether a particular supplier has changed its price recently (and therefore by implication that that price is likely to persist for some months) or whether it is about to change the price.
4. Accordingly, if the customer were to visit a price comparison site, he/she will have no idea whether the SVT that is on offer from different suppliers is likely to persist or is about to change. The customer therefore faces a risk that his/her decision may result shortly, not in a reduction in energy bills, but possibly an increase. For a less well-off customer, who has

to budget weekly, the risk of facing higher bills through changing suppliers may well weigh more heavily than the possibility of a lower bill. For all customers, this risk needs to be weighed against the inconvenience of the switching process if the customer decides to change again. The perception of risk may be heightened by the recollection of press stories about doorstep selling by energy suppliers, where many people ended up on higher tariffs than they were on before.

5. The CMA appears not to have considered such risk-aversion by the customer as a possible material factor, despite this being a wholly rational response. In a recent public lecture I gave, the audience response seemed to indicate that this concern was widespread. The CMA should expand their survey work to include a question about risk-aversion and customer perception of risk to explore the issue further.
6. In terms of remedies, a simple, but radical, approach would be to require suppliers only to change their SVT on the same day every six months. This would, however, interfere too much in the operation of the market and could discourage innovation. It cannot therefore be recommended. An alternative, which would provide customers with better information to assess the risk, would be to require price comparison sites (and energy suppliers) to state when the price of each SVT last changed. Whilst this would not protect wholly against early price changes, it would give better assurance that a change was less likely.