Domestic Competitive Market Review 2004

A review document

April 2004

Summary

This document reviews the current state of competition in domestic energy supply in Great Britain. Effective competition in the domestic supply market is important because it is the process that ensures that the benefits of competitive wholesale energy markets and efficient networks are passed on to customers. Ofgem therefore continues to monitor the development of competition in the domestic market to ensure all customers are seeing the benefits of competition.

Competition was introduced in the domestic gas and electricity markets in stages between 1996 and 1999. Before competition was introduced, British Gas was the incumbent, monopoly supplier in the gas market. In the electricity market, there were initially14 incumbent regional monopoly suppliers.

The main findings of Ofgem's review are summarised below:

Switching: For all customers, including domestic customers, supply competition has produced substantial benefits. Around half of domestic customers have now switched supplier, and customer switching rates appear to be stable and at a high level. Concerns that suppliers might focus on retaining existing customers rather than competing for new customers are not supported by Ofgem's analysis. Doorstep selling remains one of the most important ways of attracting new customers, although more and more customers are using the internet to get pricing information. Where customers have not switched supplier, this appears to be because they do not want to, rather than because they are concerned about the transfer process or they are unaware of the opportunities to change supplier and save money. However, large numbers of these customers are entering the market for the first time: over 60 per cent of customers changing supplier are doing so for the first time.

Prices: The average standard credit customer switching for the first time can save between £79 and £126 by switching to dual fuel, £92 by switching gas supplier and between £20 and £47 by switching electricity supplier, providing they shop around and switch to the cheapest supplier in their area. The two-tier pattern of prices that has prevailed since the beginning of competition, where incumbents maintained their prices to existing customers whilst offering lower prices to attract new customers, is beginning to break down. Suppliers with national brands and lower market shares in their former monopoly areas are reducing the price differential between these two groups of customers. However, it appears that most customers do not necessarily look

for the lowest price, but make their choice on a range of factors including which supplier actively approaches them, the extent of discounts and the customer's view of a supplier's brand and service levels. Customers do express significant difficulty in understanding suppliers' prices.

Prepayment: The savings available to customers using prepayment meters are markedly lower than for other customers, although the differential between standard credit and prepayment tariffs is reducing. Customers using prepayment meters have lower switching rates. It is particularly important that these customers receive good information about the offers made to them before they switch. The lower savings available to these customers may reflect higher costs of servicing them. It also appears that some suppliers may be deterred from competing for new electricity prepayment customers, possibly because of the complexities associated with different prepayment meter infrastructures in different regions. This may be acting as a barrier to entry or expansion by competing suppliers

Vulnerable customers: The latest surveys show customers from all demographic groups (by income, age, social class) are switching at broadly comparable rates. However, previous studies have shown customers over 65 switching less, and so Ofgem will continue to monitor the switching rates of this group carefully. This is of particular importance, given the prevalence of fuel poverty among older consumers.

Competition: Overall, the picture remains of a market that is competitive but not yet mature. Incumbents continue to lose market share, although at a slower rate than in the early years of competition. The pattern of discounts available to customers who choose to switch is fairly stable over time. Analysis in this review indicates that suppliers have passed reductions in electricity wholesale prices on to customers to broadly the same extent as price increases, but neither appears as a strong driver of retail prices. This may suggest that greater competition could drive prices down further. Analysis indicates that there is headroom for new entrants to enter both gas and electricity and operate profitably. Obviously new entry would help to increase competitive pressures on existing suppliers.

Scotland: The incumbent market share in the North of Scotland remains high relative to other areas, despite the availability of good discounts to customers. The proposed introduction of a Great Britain-wide wholesale electricity market should improve the margins available to suppliers competing in Scotland, although other factors such as the

difficulty of marketing dual fuel offerings in the north (as many customers are not connected to mains gas supply) are also important.

Customers with dynamic tele-switched (DTS) meters (a particular type of electricity meter that allows demand to be switched remotely to reduce demand during peak demand periods) still have severely restricted access to the benefits of competition.

Ofgem activity: Ofgem's principal objective is to protect customers' interests through the promotion of competition, wherever appropriate. Ofgem continues to believe that domestic customers' interests are best protected by a competitive supply market, where customers' ability to switch places competitive pressures on suppliers in terms of prices and standards of service. Where companies are found to be acting anti-competitively or harming customers' interests, Ofgem has extensive powers under the Competition Act and consumer protection legislation to act. Ofgem's work programme for the coming year in relation to supply markets is therefore focussed on further developing competition through:

- improving the information provided to customers at point of sale, and reviewing metering and billing rules to ensure customers have access to the information they need to make informed choices
- addressing remaining market infrastructure rigidities (for instance, the pre-payment infrastructure, dynamic teleswitched meters, debt blocking and problems with the customer transfer process)
- ensuring new entry is possible to all sectors, by reviewing Ofgem's regulation of supply markets, with one objective being to identify if entry barriers can be removed, to the benefit of customers. Ofgem will also assess if more information can be made available to prospective new entrants
- conducting further research on the role of non-price competition, including assessing whether there are barriers to increasing the diversity of contract types and structures available in the market
- working with the industry on issues concerning DTS customers. In particular Ofgem proposes to hold a seminar to discuss any information or other issues that are impeding progress in this area, and

- considering whether there are barriers to suppliers offering particular tariffs for vulnerable customers.

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1. Introduction

1.1. This chapter begins by explaining the legal and regulatory framework within which this review of the progress of competition in the domestic gas and electricity sectors has been carried out. It goes on to explain the rationale underpinning the review and then provides a brief overview of the context in which the review has been carried out.

Legal and Regulatory Framework

Ofgem's role

1.2. Ofgem, the Office of Gas and Electricity Markets, regulates the gas and electricity industries in Great Britain. It is governed by the Gas and Electricity Markets Authority ('the Authority'). Ofgem's principal objective in carrying out its functions is to protect the interests of customers, wherever appropriate by promoting effective competition[1]. Ofgem must, amongst other things, also have regard to the interests of people who are disabled or chronically sick, pensioners, those on low incomes and people living in rural areas[2]. Ofgem has a duty, so far as it appears to be practicable from time to time, to keep under review activities connected with the supply of gas and electricity[3].

Licence conditions

1.3. The Gas Act 1986 and the Electricity Act 1989 make it an offence to carry out certain activities unless licensed or exempt from the requirement for a licence[4]. Licences contain standard licence conditions[5] ('SLCs').

1.4. The SLCs in supply licences that are relevant to this review are[6]:

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[1] Electricity Act 1989 s3A(1), Gas Act 1986 s4AA.
[2] Electricity Act 1989 s3(A)(3), Gas Act 1986 s4AA(3).
[3] Electricity Act 1989 s47, Gas Act 1986 s34.
[4] Gas Act 1986 s5 (as amended by the Utilities Act 2000) and Electricity Act 1989 s4 (as amended by the Utilities Act 2000).
[5] In addition, licences may also have special conditions and/or amended standard conditions.
[6] This review does not assess the effectiveness of these licence conditions. They are referenced here as the relevant SLCs underpinning Ofgem's regulatory powers.

- SLC 12B Prohibition of Cross Subsidies – domestic and non-domestic supply licensees must not cross-subsidise, or receive any cross-subsidy from, any other business of the licensee or an affiliate or related undertaking of the licensee[7]

- SLC 32 Duty to Supply Domestic Customers – a domestic supply licensee must, other than in specified circumstances, offer to enter into a contract with a domestic customer and, where the terms offered by the supplier are accepted by the customer, supply gas or electricity to them

- SLC 42 Domestic Supply Contracts – a supplier can offer different contractual terms to different cases of customer or different classes of cases of customer, or for different areas

- SLC 48 Marketing [of gas and electricity] to Domestic Customers – which controls the way in which supply licensees market gas and electricity to domestic customers, and

- SLC 53 Basis of Charges for Top-up and Standby, Exempt Supply Services and Prepayment Meter Services: Requirements for Transparency, SLC 53A Non-discrimination in the Provision of Top-up or Standby, Exempt Supply Services and Prepayment Meter Services and SLC 53B Requirement to Offer Terms for Top-up and Standby, Exempt Supply Services and Prepayment Meter Services require certain electricity licensees (the ex-PES suppliers) to offer terms for access to their prepayment meter infrastructure to all other electricity suppliers on a non-discriminatory basis.

1.5. Other SLCs relevant to this review are:

- electricity distribution licence SLC 4A Non-Discrimination in the Provision of Use of System and Connection to System requires electricity distributors not to discriminate in the provision of use of their system between any persons or class or classes of persons, and

[7] A similar prohibition applies to some generation licensees (Generation licence SLC 17A).

- electricity distribution licence SLC 39 Restriction on Use of Certain Information and Independence of the Distribution Business requires electricity distributors to establish and maintain full managerial and operational independence from any of its affiliates and related undertakings.

Competition Act powers

1.6. Ofgem has concurrent powers with the Office of Fair Trading ('OFT') to apply the Competition Act 1998 ('the Competition Act') to the gas and electricity sectors in Great Britain. Ofgem's principal objective and duties do not apply to the concurrent exercise of powers under the Competition Act. The OFT, along with Ofgem and other sectoral regulators, has issued advice and information in accordance with Section 52 of the Competition Act, explaining how the Act will be applied and enforced. These guidelines are available on OFT's website at www.oft.gov.uk.

1.7. The Competition Act contains two prohibitions. Chapter I prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices that have as their object or effect the restriction, distortion or prevention of competition within the United Kingdom. Chapter II prohibits abuse of a dominant position by an undertaking within the United Kingdom. Any undertaking found to have breached either of the prohibitions may face a fine of up to 10 per cent of its UK group turnover for each year of the breach up to a maximum of three years.

1.8. Some chapters in this document discuss aspects of the gas and electricity sectors that concern competition law. The OFT has published guidelines[8] ('the Energy Guidelines') that set out Ofgem's framework for the application of competition law in the gas and electricity sectors. The Energy Guidelines, together with the OFT's general Competition Act Guidelines, are the primary source of guidance for companies seeking to understand the approach that Ofgem is likely to take in any potential Competition Act proceedings.

[8] "The Competition Act 1998, The application in the Energy sector", OFT 428, March 2001, OFT 428.

1.9. The Energy Guidelines provide advice and information about the factors which Ofgem is likely to take into account when considering whether, and if so how, to exercise its powers under the Competition Act. The guideline is not exhaustive. It will be necessary to consider the circumstances of each case on an individual basis, with reference to the guideline. In considering any specific complaints or an Ofgem-initiated investigation under the Competition Act, Ofgem would undertake a preliminary investigation of the facts including examining the market, the nature of any agreement, whether the conduct is unilateral and the market position of the party(ies), whilst taking into account the specific facts of the case and using the most up to date market information available to it at the time of the investigation.

1.10. This document does not provide an assessment of relevant markets that would be necessary in the context of a Competition Act investigation. Ofgem has recently published a summary of complaints considered under the Competition Act[9]. This document shows that gas and electricity supply has been a focus for complaints under the Competition Act comprising 17 out of a total of 44 complaints received by Ofgem since the introduction of the Competition Act. To date Ofgem has published two non-infringement decisions under the Competition Act, one of these related to supply competition[10]. This decision used pricing analysis to come to a preliminary view on the relevant market. However, Ofgem has never come to a formal view on the relevant market when considering Competition Act complaints in relation to supply competition.

1.11. Nothing in this document should be construed as acting as a fetter to Ofgem's discretion in its ability to act as competition authority in any proceedings.

Rationale

1.12. Ofgem believes that the competitive pressures exerted on gas and electricity suppliers are the best way to ensure that all groups of customers are protected.

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[9] Complaints considered by Ofgem under the Competition Act 1998: 1 March 2000 to 29 February 2004, 46/04, 1 March 2004, www.ofgem.gov.uk.

[10] The Gas and Electricity Market Authority's decision under the Competition Act 1998 that London Electricity plc has not infringed the prohibition imposed by Section 18(1) of the Act with regard to a 'Winback' offer, 12 September 2003, www.ofgem.gov.uk.

Ofgem's previous reviews[11] have shown that competition is producing benefits for all customers and has become an even more powerful influence on companies' behaviour. In particular, the Occasional Paper and the Recent Developments document confirmed Ofgem's view that competition was sufficiently developed that the potential for regulatory distortions caused by continuing price controls of retail supply markets would be more harmful than helpful.

1.13. Ofgem believes that its powers under the Competition Act and its ability to enforce suppliers' licence conditions are some of the principal measures that contribute to providing an effective and responsive framework for ensuring customer protection. Ofgem has, for example, imposed financial penalties on several suppliers that have breached conditions of their licence; it has also considered a number of Competition Act issues[12].

1.14. Accepted indicators of competition show that whilst competition in the domestic sectors is not yet mature, it continues to develop well. Around 50 per cent of all customers have switched their gas or electricity supplier. Switching continues at a high rate – on average 66,000 gas customers and 83,000 electricity customers switched their supplier each week during October to December 2003. The market share of incumbent suppliers has continued to fall steadily and new suppliers have entered the market.

1.15. However a number of concerns have been raised by various parties about whether customers are benefiting as much as they should be from the competitive supply sectors. The main issues that tend to be raised are:

- why so many customers are still with their incumbent electricity or gas supplier (the ex-PES[13] or BGT[14] respectively) when they tend to charge the highest prices to most customers

[11] Electricity supply competition: An Ofgem occasional paper, December 2002 83/02 (the "Occasional paper"), Domestic gas and electricity supply competition: Recent developments, June 2003, 49/03 (the "Recent Developments document"), and Review of domestic gas and electricity competition and supply price regulation: evidence and initial findings, November 2001 (the "November 2001 Review")
[12] See for example, Competition Act 1998 Decision (Chapter II case), 12 September 2003, the Gas and Electricity Market Authority's decision under the Competition Act 1998 that London Electricity plc has not infringed the prohibition imposed by section 18 (1) of the act with regard to a 'win back' offer.
[13]PES stands for Public Electricity Supplier and is the former term for the 14 companies in England, Wales and Scotland that, from privatisation in 1990 until 1998, had a monopoly of electricity supply and

- whether all groups of customers are benefiting from competition, in particular customers who pay by prepayment meter, customers in Scotland and customers who have dynamic teleswitched meters in their homes

- whether the recent decrease in switching rates compared to the earlier days of competition is a sign that competitive pressures on suppliers are decreasing

- whether consolidation in the supply sectors could lead to less competition or possibly to anti-competitive behaviour, and

- whether customers benefited fully when wholesale prices fell and whether recent price increases are reasonable given recent movements in wholesale prices.

1.16. Ofgem therefore decided to carry out a wide-ranging and detailed analysis to assess the significance of these concerns and to help direct future areas of its work. By publishing its findings in this review and its associated appendices, Ofgem hopes not only to inform interested parties about the state of the domestic energy supply markets but also to stimulate further debate about the future direction of supply competition.

Context

Brief background to domestic supply competition

1.17. Competition in the domestic gas sector was phased in between April 1996 and May 1998. For domestic electricity customers, competition was phased in between September 1998 and May 1999.

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distribution in their designated areas. Local distribution is still a monopoly regulated by Ofgem, however competition has been introduced in supply, and so these 14 suppliers are know as ex-PES suppliers.

[14] BGT stands for British Gas Trading, a large gas and electricity supplier.

Price controls

1.18. From privatisation, domestic prices were regulated through price caps. In gas, BGT's gas prices were subject to relative price regulation which capped differences between

- BGT's combined prepayment and late pay prices and its prompt pay prices, and
- between its combined prepayment and late pay prices and monthly direct debit prices.

1.19. In electricity, ex-PESs' in-area electricity prices were subject to price caps. In April 2000, Ofgem removed price controls on ex-PESs direct debit electricity prices. In April 2002 Ofgem lifted all remaining price controls.

1.20. Prior to the introduction of SLCs in October 2001, gas and electricity suppliers had non-discrimination licence conditions that imposed various obligations on them (for example not to show undue preference to any person or class of persons and not to exercise any undue discrimination against any person or class of persons). Following its consultation in July 2000[15] Ofgem decided that it was no longer appropriate to retain these conditions and that it should rely instead on its other powers including the new Competition Act to control anti-competitive behaviour in the gas and electricity supply markets.

1.21. There are currently 26 million domestic electricity customers and 21 million domestic gas customers in Great Britain. Domestic customers used a total of 112 TWh of electricity (29 per cent of total electricity use) and 376 TWh of gas (34 per cent of total gas use) in 2002[16]. Some 47 per cent of gas customers and 51 per cent of electricity customers have now switched at least once.

1.22. There are currently nine active[17] gas suppliers and 12 active electricity suppliers.

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[15] Gas and Electricity Supply Licences Proposals for Standard Non-discrimination Licence Conditions. Ofgem July 2000.

[16] These figures were taken from the DTI's Digest of United Kingdom Energy Statistics 2003, table 4.2 for gas and table 5.2 for electricity.

[17] In this context "active" means licensees, grouped by their supply companies, who are actually supplying customers (ie not the number of actual supply licences that Ofgem has granted).

Previously published relevant documents

1.23. A number of documents have been published that are relevant to this review:

Review of competition and supply price regulation

1.24. Ofgem's November 2001 Review examined a range of indicators to gauge the development of competition. These were:

- customers' experiences
- customer switching behaviour
- market shares
- price and non-price offers
- entry and exit of suppliers, and
- barriers to entry.

1.25. The review concluded that competition was protecting customers more effectively than price controls and that continuing price controls risked damaging customers' interests. Ofgem subsequently removed price controls from the remaining 30 per cent of gas customers and 50 per cent of electricity customers whose prices had been subject to price regulation[18].

1.26. In lifting these price controls Ofgem stated that competition was the best way to protect customers combined with the protection provided by competition law, licence requirements and other consumer law. However Ofgem did not completely rule out the possibility of seeking to reintroduce price controls if they would more effectively address competition concerns.

Occasional paper

1.27. In December 2002 Ofgem's Occasional Paper provided an overview of the relationship between prices, costs and competitive forces in electricity supply. It explained the factors influencing prices paid by customers in the context of

[18] Review of domestic gas and electricity competition and supply price regulation. Conclusions and final

significant wholesale electricity price reductions since October 1998. It also explained that Ofgem would not expect to see the full extent of wholesale price changes to be passed through to domestic customers since the wholesale electricity price is only one of the parts of a supplier's cost-base. (In 2002, wholesale costs comprised 39 per cent of an average domestic electricity customer's bill.) The analysis showed that price savings made customers who had switched supplier and customers who had not switched reflected the overall change in suppliers' cost base. The paper also presented evidence that competitive pressures were eroding the market shares of the ex-PESs and BGT.

National Audit Office report on the New Electricity Trading Arrangements

1.28. In May 2003 the National Audit Office ('NAO') published a report[19] into the impact of the introduction of New Electricity Trading Arrangements ('NETA'). The report showed that, since 1998, when reforms to the trading arrangements were first announced, wholesale electricity prices had fallen by around 40 per cent. It stated that many non-domestic customers had seen significant falls in the price they paid for electricity (up to 18 per cent since the start of NETA). Prices for domestic customers who had not switched had fallen little since the start of NETA, but by up to 17 per cent since April 1998 for customers who had switched supplier. The report said that although nearly 40 per cent of electricity customers had switched supplier, the apparent reluctance of others may have dampened price competition, so enabling suppliers to charge up to 22 per cent more to customers with their original supplier than they charged to attract new customers. The report recommended that Ofgem should keep under review why domestic customers who had not switched supplier had benefited much less than others from falling wholesale prices.

Recent developments in domestic supply competition

1.29. In June 2003 Ofgem's Recent Developments document provided an overview of the development of competition in the domestic energy supply sectors[20]. This showed that competitive activity continued at a high level, that incumbent

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proposals. Ofgem February 2002.

[19] The New Electricity Trading Arrangements in England and Wales. Report By The Comptroller And Auditor General HC 624 Session 2002-2003: 9 May 2003.

[20] Domestic gas and electricity supply competition. Recent developments. Ofgem 49/03.

suppliers' market shares continued to decline (albeit more slowly than before) and that customers who had not switched supplier could continue to save money and obtain good discounts by switching. However the document also recognised that there were a number of characteristics of the gas and electricity sectors that suggested it may not be a mature competitive market. These included high incumbent market shares, price competition focussed on switchers, scope for coordination and vertical integration.

1.30. The document concluded that competition was producing benefits for all groups of customers and had become an even more powerful influence on companies' behaviour. It confirmed Ofgem's view that competition was sufficiently advanced that price controls would be more harmful than helpful.

Committee of Public Accounts

1.31. In December 2003 the Committee of Public Accounts published a report into NETA[21]. The report reached a number of conclusions, and made a number of recommendations concerning domestic electricity customers including:

- electricity prices have fallen, but by much less for domestic customers than for industrial and commercial customers
- customer loyalty is penalised since those who have stayed loyal to their incumbent supplier have benefited much less from competition and pay much more than those who have switched, and
- some customers who might have liked to switch supplier have not done so because they have not had the necessary information. Others may always be resistant to the idea of 'shopping around' for a service where their interests have traditionally been protected in other ways - for instance switching rates are lower amongst the elderly. Ofgem, working with *energywatch*, should increase customer awareness of the information already available to assist the switching process including price and quality comparison services, for instance by requiring these to be signposted more visibly on customer bills.

[21] House of Commons Committee of Public Accounts. The new electricity trading arrangements in England and Wales. Second Report of Session 2003 -04. HC63.

The current review

1.32. This review seeks to explain Ofgem's views and provides an assessment of the extent of competition in domestic energy supply using the same key indicators as previous reviews but substantially developing the analysis underpinning this assessment. To support this analysis Ofgem has published a number of detailed appendices with this review. These contain a substantial amount of information about the domestic gas and electricity sectors. While much of this is already in the public domain (eg suppliers' prices) Ofgem hopes that the way the information is presented in here will be of interest to many parties.

Methodology used in the current review

1.33. This document publishes data and analysis from several sources. The main sources are:

- J.D. Power and Associates - these data provide useful insights into a range of customer satisfaction and service measures. Data on customers' experiences of domestic gas and electricity supply draw upon the J.D. Power and Associates Domestic Gas and Electricity Customer Studies for 2001, 2002 and 2003[22]

- Ofgem's domestic prices database – this contains comprehensive data on all gas and electricity domestic suppliers' prices and is updated every month

- Department of Trade and Industry ('DTI') – gas and electricity suppliers send DTI information each quarter detailing the number of customers on each of their different tariffs, and

- industry transfer information – each month electricity distribution companies' Meter Point Administration Services (MPAS) providers and domestic gas and electricity suppliers send Ofgem information about the number of customer transfers that have occurred the previous month.

[22] J.D. Power and Associates surveyed 3,277 gas customers in 2001, 3,211 in 2002 and 2,801 in 2003. They surveyed 5,009 electricity customers in 2001, 4,505 in 2002 and 3,601 in 2003. Domestic customers were interviewed by telephone during July/August of 2001, 2002 and 2003? across Great Britain. The sample size of these studies is comparable to studies undertaken in previous years by MORI.

1.34. In November 2003 Ofgem commissioned Frontier Economics ('Frontier') to analyse various data about the domestic gas and electricity sectors in order to gain a better understanding of the key determinants of customer switching behaviour. Frontier used information from Ofgem's domestic prices database, the industry transfer figures and J.D. Power and Associates' surveys. Where relevant to this review, Frontier's findings are presented in this document. Frontier is currently developing for Ofgem an economic model of competition that is driven by market structure, relative prices, brand value, supplier strategies (eg product differentiation, price discrimination, selling strategies etc) and switching costs. This will help further improve Ofgem's understanding of supplier behaviour and potentially provide insights into possible developments in competition under different future scenarios. Frontier has also carried out some analysis on the responsiveness of retail prices to changes in wholesale prices.

Structure of this document

1.35. The rest of this document is structured in the following way:

- Chapter 2 considers a variety of evidence about customers' experiences of gas and electricity competition including how aware customers are of the fact that they can change their gas and electricity supplier, how easy customers find it to compare prices and some of the reasons why customers choose or choose not to switch supplier

- Chapter 3 analyses customers' switching behaviour in more detail and includes some of the results of research that Ofgem commissioned into customer switching behaviour. The chapter includes statistics about switching, a discussion of how price and other factors influence customers' switching decisions and how switching behaviour may influence suppliers' pricing strategies

- Chapter 4 gives a detailed analysis of suppliers' prices and considers the extent to which suppliers are passing on changes in wholesale prices to domestic customers. It also discusses what other features ('non-price' factors) of a supplier's product may influence a customer's decision to switch

- Chapter 5 analyses some information about supplier profitability and the implications for the potential for new entry into the supply sector

- Chapter 6 examines some of the structural features of the domestic energy supply markets and discusses what these features might mean for the development of competition

- Chapter 7 considers the extent of barriers to entry and growth in the domestic energy supply market. It re-visits and updates work that Ofgem has carried out in this area in previous reviews, and

- Chapter 8 draws together the main findings of this review. It gives Ofgem's views on the findings and, where relevant, explains what further work Ofgem intends to undertake in the light of these findings.

1.36. Chapters 2 - 7 are all structured in a similar way:

  - the 'Background' section explains why the particular issue is important in assessing the development of competition

  - the 'Terminology and data' section explains important concepts, words and phrases used in the Chapter. If any of the definitions or ways of measuring them have changed since previous documents were published this is also explained

  - the 'Key Facts and Trends' section provides a high level summary of the key findings of the chapter, and

  - the 'Analysis' section discusses in detail the work that Ofgem has carried out and what the findings mean for customers, the development of competition and future Ofgem work.

- the Glossary at the back of this document contains explanations of the key terms used in the document, and

- Ofgem has published separate documents containing detailed appendices.

Views invited

1.37. Ofgem is planning to hold a seminar to discuss the issues raised by this review. This is likely to be held around mid-June and it would be helpful if those interested in attending could let Fran.Gillon@ ofgem.gov.uk know by 30 April 2004.

1.38. Ofgem also welcomes written comments on any of the issues raised in this document.

These should be sent to:

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The closing date for responses is 30 June 2004.

Contact

1.39. If you wish to discuss any of the issues raised in this document please contact either:

- Chris Bowley (020 7901 7372, chris.bowley@ofgem.gov.uk)
- Michael Byrne (020 7901 7177, michael.byrne@ofgem.gov.uk), or
- Emma King (020 7901 7018, emma.king@ofgem.gov.uk).

Confidentiality

1.40. All responses will normally be published on the Ofgem website and held electronically in the Ofgem Research and Information Centre unless they are marked confidential. Respondents should try to confine confidential information to the appendices of their responses. Ofgem would prefer to receive non-confidential responses and to receive responses in an electronic form.

2. Customers' experiences

2.1. This chapter considers a variety of evidence about customers' experiences of gas and electricity supply competition, in particular:

- how aware customers are of the fact that they can change their gas and electricity supplier(s)
- how satisfied customers are with their current suppliers
- whether customers are able to compare suppliers' prices easily
- whether customers have experienced (or perceive) the switching process as easy
- customers' reasons for choosing to switch or choosing not to switch, and
- type of contact with suppliers.

Background

2.2. Information about customers' experiences is a key aspect of assessing the overall performance of the gas and electricity domestic supply markets. It enables Ofgem to quantify customers' ability to make informed choices and thus to assess the extent to which they are benefiting from the competitive process.

2.3. Ofgem monitors customers' experiences by obtaining customer survey data and analysing it to understand how domestic supply competition works at the level of the individual customer. Data on customers' experiences provides a richer account of how competition works when combined with other 'hard' data on prices, supplier concentration and switching.

Terminology and data

2.4. No special terminology or data is needed to understand the concepts discussed in this chapter. Information about specific terms is in the Glossary at the end of this document.

Measurement issues

2.5. Ofgem has previously assessed the development of supply competition by analysing customer survey data. In 2001, Ofgem commissioned research by MORI[23] to determine how the dynamic process of competition was meeting customers' expectations and demands[24].

2.6. MORI conducted 2,310 interviews with domestic electricity and gas customers. Interviews were conducted with the person wholly or jointly responsible for paying the household's electricity and gas bills and who could make the decision to change supplier. All interviews were conducted face-to-face, in the home.

2.7. Ofgem's Recent Developments document presented J.D. Power and Associates' customer survey data[25]. In that document, Ofgem provided a reconciliation of results between the MORI and J.D. Power and Associates' survey results.

2.8. For this current review, Ofgem has used three years' customer survey data from J.D. Power and Associates. Domestic customers were interviewed by telephone during the summer in 2001, 2002 and 2003. The surveys vary in size[26] but they are each larger than that undertaken by MORI. The domestic gas survey was boosted in 2003 to include a further 400 BGT customers.

2.9. Wherever necessary, Ofgem will comment on how the survey results obtained from data supplied by J.D. Power and Associates differ from those produced by MORI in 2001.

2.10. Ofgem has used the following methodology in its use and interpretation of customer survey data:

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[23] Market and Opinion Research International.
[24] "Experience of the competitive domestic electricity and gas markets: Research Study conducted by MORI for Ofgem", November 2001, 72/01.
[25] United Kingdom Gas Supplier Domestic Customer Satisfaction Study, 2001, 2002, 2003. United Kingdom Electricity Supplier Domestic Customer Satisfaction Study, 2001, 2002, 2003.
[26] In 2003, the surveys sampled 2801 domestic gas customers and 3601 domestic electricity customers. In 2002, the surveys sampled 3211 gas and 4505 electricity customers. In 2001, the surveys sampled 3,277 gas customers and 5,009 electricity customers.

- the review reports sample sizes for all tabled statistics in Appendix 1. Ofgem does not report findings for sample sizes of less than 100. This is to ensure that policy decisions based on survey data are robust

- the review reports on percentages for customer responses to a range of questions, with raw (unweighted) responses included in Appendix 1. This provides a transparent means for identifying the actual number of respondents to a question in addition to the reported proportions, and

- the review stratifies customer experience data by demographic categories including:

  - payment method
  - switcher or non-switcher
  - income
  - social grouping
  - region, and
  - age.

Key facts and trends

2.11. This section summarises the findings in the six key areas of customer experience analysed in this review:

- customer awareness – there are very high levels of awareness of gas and electricity competition over time and across all demographic groups, although prepayment customers have lower levels of awareness than the average

- satisfaction – a majority of customers are satisfied with their gas and electricity suppliers

- transparency of pricing information – a majority of customers find it very easy or fairly easy to compare prices, although just over a quarter do not. There has been a fall in the number of customers who have been contacted

by a doorstep sales agent. More customers are getting pricing information from the internet

- ease of switching – the majority of gas and electricity switchers and non-switchers found (or perceive) switching to be easy, although the percentage is lower for non-switchers

- reasons for switching or not switching – price continues to be the main driver of customer switching, with switching levels increasing for all customer groups year on year. Some customers cite quality and reliability of power supply as a reason for not switching, even though these factors are not supplier related, and

- contact with suppliers – doorstep selling continues to be the way in which most customers have contact with suppliers although telephone contact is increasing as a sales route.

2.12. Each of these issues is discussed in detail below.

Analysis

Customer awareness

2.13. A precondition for effective supply competition is that customers are aware of their right to choose an alternative supplier and thereby save money on their bills. Measuring the awareness of competition assists in identifying the nature of any gaps in customer understanding of the choices available to them.

2.14. The extent to which customers are aware and the extent to which they exercise these choices could have far reaching implications for the structure of the market and the conduct of suppliers within the market. For instance, a decrease in customer awareness could act to lower switching rates, which could in turn deter future growth and entry by suppliers into the market.

2.15. This section therefore examines whether gas and electricity customers are aware of the choices available to them.

Gas

2.16. Table 2.1 shows that since 2002, the proportion of customers who state that they are aware that they can buy gas from a supplier other than their local gas supplier[27] has remained unchanged (92 per cent)[28].

Table 2.1: Were you already aware that you can now buy gas from suppliers other than your local gas supplier?

	2001	2002	2003
Percentage (%)	95	92	92

Source: J.D. Power and Associates

2.17. Ofgem has considered whether this result provides an accurate reflection of the extent of customer awareness of competition. 'Awareness' in the context of the question in Table 2.1 is specific - it relates to the customer knowing whether they can switch supplier. On this basis, the question seems a reliable, well defined measure of awareness.

2.18. Alternatives to this question were used in Ofgem's 2001 review. In 2001, MORI measured awareness by asking respondents how many suppliers they could name. In gas, 69 per cent could name at least two gas suppliers. Just under one quarter (23 per cent) responded naming four or more suppliers, while just over one quarter (27 per cent) of respondents could cite only one gas supplier (presumably British/Scottish Gas).

2.19. This raises an issue about the comparability of the MORI results with the J.D. Power and Associates' results in 2001. The large difference in reported awareness levels between the two surveys for the same period suggests that the two surveys are picking up different aspects of customers' concept of awareness.

2.20. The MORI question was prompted, and sought customer recognition of specific brands or suppliers offering choice[29]. The J.D. Power and Associates' survey elicits a slightly less 'active' understanding of what choice is available in the market. In the J.D. Power and Associates' survey, customers were asked

[27] Ideally, the question would have referred to BGT and not local gas supplier since the latter could be taken to be supply by an ex-PES supplying gas in that locality.
[28] The higher reported awareness figure for 2001 is likely to reflect sampling variation rather than a peak in actual awareness levels.
[29] Using showcards with suppliers' names, the interviewee asked respondents "Which of these companies

whether they were aware they could purchase their gas from another supplier, without being tested on their recognition of actual suppliers' names. Results could therefore be expected to be lower for MORI, given that respondents were required to recall names of suppliers active in their region.

2.21. In addition to assessing general levels of awareness of competition Ofgem is also able to analyse whether there are differences in levels of awareness between different types of customer. Ofgem has analysed the level of awareness among domestic gas customers by the following demographic characteristics:

- payment type
- income
- social grouping
- comparing England and Wales to Scotland, and
- age.

are you aware of selling gas in this area?"

Table 2.2: Awareness by demographic breakdowns in gas

Demographic Categories	2001	2002	2003
All domestic gas customers	95	92	92
Payment type			
Direct Debit	98	91	94
Standard Credit	93	93	92
Prepayment	93	89	86
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	95	90	87
£10,000 - £25,000	97	91	94
£25,000 - £49,999	97	94	95
£50,000 +	98	93	97
Don't know	92	89	91
Refused	no category	97	92
Social Grouping			
AB	97	91	94
C1	98	92	95
C2	93	94	93
DE	92	89	88
Refused	n/a (sample < 100)	n/a (sample < 100)	94
Region			
England and Wales	n/a	92	93
North of Scotland	n/a	91	89
South of Scotland	n/a	90	90
Age			
< 25	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
25-34	93	87	87
35-44	98	94	96
45-54	95	91	95
55-64	96	93	93
65 +	93	93	90
Don't know/refused	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)

Source: J.D. Power and Associates

2.22. Customer awareness has remained at high levels, both nationally and across customer groups. However some customer groups have experienced falls in awareness. For instance:

- prepayment (93 per cent to 86 per cent), and
- income less than £10,000 a year (95 per cent to 87 per cent).

Electricity

Table 2.3: Were you already aware that you can now buy electricity from suppliers other than your local electricity supplier?

	2001	2002	2003
Percentage (%)	94	92	93

Source: J.D. Power and Associates

2.23. Table 2.3 shows that since 2001, customer awareness has remained broadly unchanged.

2.24. In 2001, MORI measured awareness by asking respondents how many suppliers they could name. In electricity, 77 per cent could name at least two electricity suppliers. Just over one third (35 per cent) responded naming four or more suppliers, while 19 per cent of respondents could cite only one electricity supplier (presumably their ex-PES).

2.25. As with gas, MORI results for 2001 contrast with J.D. Power and Associates' results which identify awareness levels at 94 per cent. As with gas, the results may be lower for MORI because customers were required to recall names of suppliers active in their region.

2.26. As for gas, Ofgem has analysed the level of awareness among domestic electricity customers by the following demographic characteristics:

- payment type
- income
- social grouping
- comparing England and Wales to Scotland, and

- age.

Table 2.4: Awareness by demographic breakdowns in electricity

Demographic Categories	2001	2002	2003
All domestic electricity customers	94	92	93
Payment type			
Direct Debit	96	94	96
Standard Credit	94	92	93
Prepayment	92	86	85
Don't know/other	n/a(sample < 100)	n/a(sample < 100)	n/a(sample < 100)
Income			
< £10,000	92	86	91
£10,000 - £25,000	96	93	94
£25,000 - £49,999	97	95	97
£50,000 +	95	96	97
Don't know	90	92	89
Refused	no category	94	93
Social Grouping			
AB	96	97	97
C1	96	94	94
C2	95	93	94
DE	91	88	89
Refused	n/a (sample < 100)	n/a (sample < 100)	89
Region			
England and Wales	n/a	92	93
North of Scotland	n/a	88	89
South of Scotland	n/a	91	91
Age			
< 25	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
25-34	94	90	93
35-44	96	94	94
45-54	95	94	95
55-64	96	93	94
65 +	92	90	93
Don't know/refused	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)

Source: J.D. Power and Associates

2.27. Customer awareness remains at high levels for all customer groups. Slight changes in reported awareness levels may reflect sampling variation in the data rather than a change in actual awareness levels. However, as with gas, some customer groups have experienced falls in awareness. For instance, prepayment customer awareness fell from 92 per cent in 2001 to 85 per cent in 2003.

Summary

2.28. Overall, awareness levels remain high across all customer groups. However for both gas and electricity, prepayment customers appear to be less aware than the national average (although the level of awareness is still high (85 - 86 per cent)). This awareness appears to be falling over time.

2.29. For prepayment customers, Ofgem will use this information on awareness, together with other information presented in this document, to inform a joint information strategy with energywatch which is due to be launched in autumn this year. Ofgem will also continue its dialogue with energywatch and other organisations that are particularly concerned about prepayment customers that are in fuel poverty to decide what further action, if any, it would be appropriate for Ofgem to take. However it is important to remember that approximately 10 per cent[30] of prepayment customers are in fuel poverty compared to 22 per cent of pensioners[31]. Policy initiatives therefore need to be balanced to ensure that they address the needs of all customer groups.

Customer satisfaction

2.30. Customer satisfaction is an important indicator of whether suppliers are responding adequately to changing customer preferences over time.

2.31. Ofgem considers that competitive pressures (such as those that arise from service differentiation or innovation) are the most efficient way to ensure that suppliers are able to meet these changing demands.

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[30] UK Fuel Poverty Strategy, November 2001: Detailed breakdowns of fuel poverty in England in 2001. 11 per cent of electricity prepayment customers are in fuel poverty. In gas, 9 per cent of prepayment customers are in fuel poverty. Further fuel poverty statistics can be found at www.dti.gov.uk/energy/consumers/fuel_poverty/england2001analysis.pdf.

[31] ibid.

2.32. This section examines whether satisfaction levels have changed since 2001 and, if so, for which customer groups.

Gas

2.33. The J.D. Power and Associates' customer surveys show the following key findings on customer satisfaction.

Table 2.5: Overall, how would you rate your gas supplier as a provider services to your home?[32]

Percentage (%)	2001	2002	2003
Highly satisfied	77	81	76
Indifferent	18	12	15
Disappointed	4	5	8
Don't know	0	1	1

Source: J.D. Power and Associates

2.34. In response to this question, customers were asked to rate their supplier on a scale of 1 to 10[33]. Table 2.5 reports how customers have rated their supplier (ie, those that are highly satisfied (8-10), indifferent (6-7), disappointed (1-5) or don't know). The results suggest high levels of satisfaction, with at least three quarters of customers reporting being highly satisfied in all three years.

2.35. Although the number of customers who are dissatisfied is very small, there is a marked increase in dissatisfaction between 2001 and 2003. The proportion of customers who say they are disappointed doubles from 4 per cent in 2001 to 8 per cent in 2003. The results for 2001 are consistent with those obtained by MORI in 2001; in that survey, less than five per cent of customers were dissatisfied.

2.36. Ofgem has examined satisfaction for the following sub-groups:

- payment type
- income

[32] Ideally the question would have referred to gas supply since the concept of services could be taken to include other services such as boiler servicing to energy efficiency.
[33] The 2002 and 2003 surveys use a 10 point numerical scale whereas in 2001 a 5 point semantic scale is used.

- social grouping
- switcher/non-switcher
- comparing England and Wales to Scotland, and
- age.

Table 2.6: Customers 'highly' satisfied in gas: key demographic breakdowns

Demographic Categories	2001	2002	2003
All domestic gas customers	77	81	76
Payment type			
Direct Debit	78	83	75
Standard Credit	78	82	78
Prepayment	76	75	74
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	79	80	83
£10,000 - £25,000	78	85	73
£25,000 - £49,999	81	75	70
£50,000 +	69	63	76
Don't know	74	85	81
Refused	no category	84	72
Social Grouping			
AB	74	83	70
C1	78	79	73
C2	77	81	77
DE	78	85	83
Refused	n/a (sample < 100)	n/a (sample < 100)	70
Switchers[34]			
switcher	73	80	73
non-switcher	80	82	79
Region			
England and Wales	n/a	83	75

[34] This is derived from the group of customers who are already aware that they can buy gas/electricity from suppliers other than their local supplier; it therefore excludes those customers who are not aware of this choice. This group is not reported in the document.

North of Scotland	n/a	69	78
South of Scotland	n/a	73	79
Age			
<25	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)
25-34	82	65	62
35-44	81	74	74
45-54	75	86	71
55-64	73	79	81
65+	80	93	85
Don't know/refused	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)

Source: J.D. Power and Associates

2.37. Table 2.6 illustrates that, for highly satisfied customers, satisfaction levels in 2003 do not differ significantly from their levels in 2001 for most customer groups.

2.38. In 2003, the proportion of highly satisfied prepayment customers (74 per cent) and customers who live in Scotland (78 per cent in the North of Scotland and 79 per cent in the South of Scotland) is near to or above the national average (76 per cent).

2.39. A lower proportion of switchers rate being highly satisfied with their supplier than non-switchers (73 per cent compared to 79 per cent).

2.40. Table 2.7 identifies the proportion of customers who are indifferent to their supplier's performance.

Table 2.7: Customers indifferent to supplier in gas: key demographic breakdowns

Demographic categories	2001	2002	2003
All domestic gas customers	18	12	15
Payment type			
Direct Debit	19	12	16
Standard Credit	16	12	14
Prepayment	17	11	15
Don't know/other	n/a (sample <100)	n/a (sample <100)	n/a (sample <100)
Income			
<£10,000	20	13	11

£10,000 - £25,000	16	11	16
£25,000 - £49,999	13	13	20
£50,000 +	19	32	19
Don't know	22	7	12
Refused	no category	12	16
Social Grouping			
AB	18	11	21
C1	19	14	20
C2	16	14	13
DE	18	8	9
Refused	n/a (sample < 100)	n/a (sample < 100)	14
Switchers			
switcher	22	13	17
non-switcher	16	12	14
Region			
England and Wales	n/a	10	16
North of Scotland	n/a	29	16
South of Scotland	n/a	18	11
Age			
< 25	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
25-34	14	19	26
35-44	15	14	14
45-54	18	12	18
55-64	22	16	12
65 +	16	4	10
Don't know/refused	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)

Source: J.D. Power and Associates

2.41. Table 2.7 indicates that the proportion of customers who say they are indifferent has in most cases declined since 2001.

Table 2.8: Customers disappointed with supplier in gas: key demographic breakdowns

Demographic Categories	2001	2002	2003
All domestic gas customers	4	5	8
Payment type			
Direct Debit	2	4	8
Standard Credit	5	4	6

Prepayment	7	13	11
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	1	7	5
£10,000 - £25,000	5	3	10
£25,000 - £49,999	5	11	9
£50,000 +	12	4	4
Don't know	3	4	6
Refused	no category	3	11
Social Grouping			
AB	7	6	8
C1	2	6	7
C2	6	3	10
DE	3	6	7
Refused	n/a (sample < 100)	n/a (sample < 100)	13
Switchers			
switcher	4	5	9
non-switcher	4	5	6
Region			
England and Wales	n/a	5	8
North of Scotland	n/a	1	5
South of Scotland	n/a	9	9
Age			
< 25	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
25-34	5	13	11
35-44	4	11	10
45-54	6	2	10
55-64	3	5	6
65 +	3	1	3
Don't know/refused	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)

Source: J.D. Power and Associates

2.42. Although overall levels of disappointment are very low, they are increasing. Prepayment customers consistently report higher levels of dissatisfaction than any other payment group.

Electricity

2.43. Table 2.9 reports customer satisfaction with their electricity supplier.

Table 2.9: Overall, how would you rate your electricity supplier as provider of services to your home?

Percentage (%)	2001	2002	2003
Highly satisfied	70	74	69
Indifferent	25	16	20
Disappointed	4	10	10
Don't know	1	1	1

Source: J.D. Power and Associates

2.44. In response to this question, customers were asked to rate their supplier on a scale of 1 to 10[35]. Table 2.9 reports how customers have rated their supplier (ie, those that are highly satisfied (8-10), indifferent (6-7), disappointed (1-5) or don't know). The results suggest high levels of satisfaction, with a significant majority of customers reporting being highly satisfied in all three years[36].

2.45. Ofgem has examined satisfaction for the following subgroups:

- payment type
- income
- social grade
- switcher/non-switcher
- comparing England and Wales to Scotland, and
- age.

[35] The 2002 and 2003 surveys use this 10 point numerical scale whereas in 2001 a 5 point semantic scale is used.
[36] The results are consistent with those obtained by MORI in 2001; in that survey 3 per cent of customers were dissatisfied.

Table 2.10: Customer 'highly' satisfied in electricity: key demographic breakdowns

Demographic Categories	2001	2002	2003
All domestic gas customers	70	74	69
Payment type			
Direct Debit	70	74	70
Standard Credit	69	73	67
Prepayment	72	74	74
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	78	83	76
£10,000 - £25,000	72	74	70
£25,000 - £49,999	64	66	63
£50,000 +	55	61	52
Don't know	67	74	77
Refused	no category	74	68
Social Grouping			
AB	62	70	62
C1	69	72	64
C2	70	72	72
DE	74	79	77
Refused	n/a (sample < 100)	n/a (sample < 100)	72
Switchers			
switcher	65	73	68
non-switcher	73	75	70
Region			
England and Wales	n/a	74	69
North of Scotland	n/a	69	68
South of Scotland	n/a	76	72
Age			
< 25	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
25-34	65	63	56
35-44	63	65	65
45-54	67	71	67
55-64	74	74	73
65 +	76	84	81
Don't know/refused	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)

Source: J.D. Power and Associates

2.46. The results in Table 2.10 show customers who are highly satisfied. There has been little change in the proportion of customers indicating that they are satisfied with the service provided by their electricity supplier, either across time or by customer group.

2.47. In 2003, the proportion of highly satisfied prepayment customers (74 per cent) and customers in Scotland (68 per cent in the North of Scotland and 76 per cent in the South of Scotland) is near to or above the national average (69 per cent).

Table 2.11: Customers indifferent to supplier in electricity: key demographic breakdowns

Demographic categories	2001	2002	2003
All domestic gas customers	25	16	20
Payment type			
Direct Debit	26	17	22
Standard Credit	26	15	20
Prepayment	22	12	15
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	18	9	16
£10,000 - £25,000	23	15	20
£25,000 - £49,999	32	22	28
£50,000 +	40	23	32
Don't know	27	14	14
Refused	no category	18	19
Social Grouping			
AB	33	20	25
C1	26	17	25
C2	26	15	19
DE	21	12	13
Refused	n/a (sample < 100)	n/a (sample < 100)	17
Switchers			
switcher	29	17	20
non-switcher	23	15	20
Region			
England and Wales	n/a	16	20
North of Scotland	n/a	17	19

South of Scotland	n/a	14	17
Age			
<25	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)
25-34	29	21	31
35-44	32	21	22
45-54	28	18	21
55-64	21	14	20
65+	20	10	10
Don't know/refused	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)

Source: J.D. Power and Associates

2.48. Table 2.11 indicates that the proportion of customers who say they are indifferent has in most cases declined since 2001.

Table 2.12: Customers disappointed with their supplier in electricity: key demographic breakdowns

Demographic Categories	2001	2002	2003
All domestic gas customers	4	10	10
Payment type			
Direct Debit	3	8	8
Standard Credit	4	10	11
Prepayment	5	13	10
Don't know/other	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)
Income			
<£10,000	3	7	8
£10,000 - £25,000	5	10	9
£25,000 - £49,999	4	12	9
£50,000+	5	17	14
Don't know	4	10	8
Refused	no category	7	12
Social Grouping			
AB	4	10	12
C1	4	10	10
C2	4	11	8
DE	4	8	9
Refused	n/a (sample<100)	n/a (sample <100)	6

Switchers			
switcher	5	10	10
non-switcher	4	9	9
Region			
England and Wales	n/a	10	10
North of Scotland	n/a	12	8
South of Scotland	n/a	8	10
Age			
<25	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)
25-34	6	15	12
35-44	5	13	12
45-54	5	10	11
55-64	4	10	6
65+	2	6	8
Don't know/refused	n/a (sample<100)	n/a (sample<100)	n/a (sample<100)

Source: J.D. Power and Associates

2.49. Overall levels of disappointment are low and appear to be stable over time.

Summary

2.50. Overall the results suggest the following:

- in both gas and electricity, the significant majority of customers report high levels of satisfaction with their supplier
- levels of reported customer disappointment are low but are increasing, and
- in gas, a lower proportion of switchers report high levels of satisfaction than non-switchers. Gas prepayment customers consistently report higher levels of disappointment.

2.51. Many customers are satisfied with the service their supplier provides on a day to day basis. However, it could be argued that what really matters to a customer is what happens when something goes wrong. The increase in dissatisfaction levels may be picking up customer disappointment about how suppliers remedy problems.

2.52. The increase in disappointment levels may be linked to well publicised accounts of problems in the transfer process, misselling and billing complaints which have been highlighted by energywatch. Ofgem is actively seeking solutions to these problems by working with industry bodies to ensure suppliers are tackling these issues. However increasing dissatisfaction could indicate rising customer expectations about the standard of service they want. This could therefore be an indicator of increasing competitive pressures on suppliers since customers can switch if they are dissatisfied.

Transparency of pricing information

2.53. A key question for this review is whether customers have made, or can be expected to make, informed choices based on pricing information available to them. If customers do not have pricing information that they can easily understand, they may not be making informed choices about switching. Therefore, Ofgem would like better understand the extent to which customers find pricing information easy to understand.

2.54. If it appears that many customers find the available pricing information unhelpful, confusing or misleading (for example, either because they say so in customer surveys or because they appear to be switching to more expensive suppliers) then Ofgem will need to assess whether this is because gas and electricity prices are inherently complex, or whether there is a need for additional information to be provided to customers.

2.55. This section examines responses to survey questions that identify how easy customers find it to make price comparisons.

Gas

2.56. Domestic gas customers who had compared prices were asked how easy they found it. Table 2.13 reports the results.

Table 2.13: How easy was it to compare tariffs between gas suppliers?

Percentage (%)	2001	2002	2003
Very easy	33	24	25
Fairly easy	41	48	43

Not very easy	19	19	20
Not at all easy	6	7	9
Don't know	1	1	4

Source: J.D. Power and Associates

2.57. Overall, the proportion of customers who say that comparing gas tariffs is fairly easy or very easy has fallen from 74 per cent in 2001 to 68 per cent in 2003[37].

2.58. When gas customers were asked where they obtained pricing information to make price comparisons, the following responses were given.

Table 2.14: Where did you get the information from in order to make comparisons between gas suppliers? (Top five responses in 2003, multiple responses allowed, not prompted)

Percentage (%)	2001	2002	2003
Representative who called at home (visited)	45	35	30
Directly from gas company	20	24	21
Newspaper/magazine article	10	10	13
Internet – Total	4	5	12
Representative who made a telephone call to home	10	9	9

Source: J.D. Power and Associates

2.59. The results indicate that doorstep sales agents are the single largest provider of pricing information to customers, with 30 per cent of respondents reporting this source in 2003. Information provided on the doorstep is clearly the principal way in which customers make such comparisons, and the fact that it is provided at the point of selling underscores its importance to the decision to switch. The proportion of customers who have obtained information from doorstep sales agents has, however, fallen from 45 per cent to 30 per cent since 2001.

2.60. Other important sources include direct contact from the supplier, although it is not clear what form this direct contact takes and might also include doorstep sales. The internet is also becoming an increasingly important source of

[37] In 2001 MORI reported that 40 per cent of customers found price comparisons easy and 35 per cent found them difficult.

information for making pricing comparisons, increasing from 4 per cent to 12 per cent[38].

Electricity

2.61. Table 2.15 reports the survey results of electricity customers who were asked how easy they found it to compare prices.

Table 2.15: How easy was it to compare tariffs between electricity suppliers?

Percentage (%)	2001	2002	2003
Very easy	22	26	26
Fairly easy	45	43	43
Not very easy	21	20	21
Not at all easy	10	9	7
Don't know	1	3	3

Source: J.D. Power and Associates

2.62. There has been little change in the proportion of customers who say that comparing prices is fairly easy or very easy (67 per cent in 2001 compared to 69 per cent in 2003)[39].

2.63. Electricity customers were also asked about their source of information from which to compare suppliers.

Table 2.16: Where did you get the information from in order to make comparisons between electricity suppliers? (Top five responses in 2003, multiple responses allowed, not prompted)

Percentage (%)	2001	2002	2003
Representative who called at home (visited)	40	33	34
Directly from electricity company(ies)	20	21	27
Internet – total	4	6	10
Representative who made a telephone call to Home	15	9	9
Newspaper/magazine article	17	12	9

Source: J.D. Power and Associates

[38] In 2001 MORI reported that two thirds of customers had been approached by suppliers who told them how to compare prices.
[39] In 2001 MORI reported that 40 per cent of customers found price comparisons easy and 35 per cent found them difficult.

2.64. Table 2.16 illustrates the importance of doorstep sales agents as a source of information to compare electricity prices. The internet continues to be important as a source of information for comparing prices. Interestingly, as for gas, respondents obtaining information from doorstep sales agents has fallen from 40 per cent to 34 per cent since 2001[40].

Summary

2.65. The results of the J.D. Power and Associates' customer surveys suggest that the majority of customers continue to find making price comparisons easy or very easy, although a significant proportion of customers do not. Although in decline, doorstep sales are still the most important source of pricing information for customers.

2.66. It is vital that pricing information is transparent, relevant and accurate for the customers who use it, particularly where it underpins the decision to switch supplier. Chapter 3 of this review discusses whether customers may switch in reaction to information from suppliers rather than maximising their savings by shopping around.

2.67. In December 2003 Ofgem put forward proposals for changes to the licence condition that controls most suppliers' marketing activities[41]. The proposals included prohibitions (for example to prevent suppliers giving misleading information or selling to minors) and obligations (such as providing an accurate information for customers and a 14-day cancellation period). Although customer groups were happy with the proposals, other responses suggested that more work is needed on the relationship between licence enforcement and self-regulation. Ofgem has therefore decided to roll over the existing condition for a further two years to March 2006 and, in the meantime, to seek to identify a practical solution that delivers real customer benefit.

2.68. Ofgem will continue to monitor suppliers' provision of pricing information to customers, as this remains their single most important source of comparison.

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[40] In 2001 MORI reported that, as in gas, two thirds of customers had been approached by suppliers who told them about how to compare prices.

[41] "Making markets work for consumers. The regulation of gas and electricity sales and marketing: proposals for the amendment of standard licence condition 48: A consultation document", December 2003, Ofgem.

Ofgem will also publish proposals on improving the information available to customers to help them make the best choice if they decide to switch. This is likely to include consideration of the role of information on customers' bills and meter reading.

Ease of switching

2.69. This section examines how customers perceive or experience the customer transfer process. Customer perceptions and experiences of the transfer process will play an important part in determining whether they believe they should switch in the future.

2.70. From time to time there are highly publicised stories about how the transfer process had gone wrong for some customers. Clearly, such stories may have been factored more broadly into customers' perceptions of the transfer process.

2.71. Since Ofgem's 2001 review, it has not conducted a detailed examination of the experiences of switching customers[42]. In light of recent and highly publicised mis-selling and objections cases, Ofgem wants to understand how these factors impact on the process at an individual customer level.

Gas

2.72. Domestic gas customers were asked how easy they found the process of switching. Table 2.17 reports the key results.

Table 2.17: Thinking about the last time you switched gas supplier, how easy did you find the whole process?

Percentage (%)	2001	2002	2003
Very easy	62	57	55
Fairly easy	22	22	24
Not very easy	8	10	10
Not at all easy	9	11	11
Don't know	0	0	0

Source: J.D. Power and Associates

[42] Ofgem reported key results from the J.D. Power and Associates' 2002 and 2001 survey in its Recent Developments document. However, it did not provide a detailed assessment based on that data.

2.73. Over 75 per cent of gas customers report their switching experience to have been fairly easy or very easy, although 21 per cent of customers found it not very easy or not at all easy[43].

2.74. The survey also reports on customers' perceptions of the switching process by asking survey respondents who have never changed supplier "If you were to change, how easy would you expect the whole process to be?"

Table 2.18: If you were to change gas supplier, how easy would you expect the whole process to be?

Percentage (%)	2003
Very easy	30
Fairly easy	33
Not very easy	12
Not at all easy	10
Don't know	15

Source: J.D. Power and Associates

2.75. The results indicate that a majority (63 per cent) of gas customers who have never switched perceive the switching process to be fairly easy or very easy.

Electricity

Table 2.19: Thinking about the last time you switched electricity supplier, how easy did you find the whole process?

Percentage (%)	2001	2002	2003
Very easy	60	57	58
Fairly easy	25	28	25
Not very easy	7	8	8
Not at all easy	7	8	9
Don't know	1	0	0

Source: J.D. Power and Associates

2.76. In electricity, the vast majority of survey respondents consistently report that their switching experience was easy or very easy (83 per cent in 2003). This is slightly higher than in gas[44].

[43] In 2001 MORI found that 88 per cent of customers found switching easy and 10 per cent found it difficult.
[44] In 2001 MORI found that 88 per cent of electricity customers found switching easy and nine per cent

2.77. The proportion of customers who report that they found the process not at all easy has increased slightly from seven per cent in 2001 to nine per cent in 2003.

2.78. The survey also reports on customers' perceptions of the switching process by asking survey respondents who have never changed supplier "If you were to change, how easy would you expect the whole process to be?"

Table 2.20: If you were to change electricity supplier, how easy would you expect the whole process to be?

Percentage (%)	2003
Very easy	29
Fairly easy	32
Not very easy	13
Not at all easy	13
Don't know	13

Source: J.D. Power and Associates

2.79. The results indicate that 61 per cent of electricity customers who have never switched perceive the switching process to be easy or very easy. This result is consistent with the result for gas. This indicates that perceptions about the switching process are unlikely to be a major factor in these customers' decisions whether or not to switch. This appears consistent with the evidence on stated reasons for switching or not switching in the following section, in which perceptions of the switching process are not cited as reason for switching or not switching.

Summary

2.80. The survey results suggest that the majority of customers who switch find the process very easy or easy. A majority of those who have not switched perceive that the process would be easy although, as might be expected, a greater number of non-switchers than switchers perceive the process to be not very easy or not at all easy.

2.81. Ofgem will continue to work with industry and energywatch to ensure that problems with the transfer process are minimised. It will continue to support the

industry's Customer Transfer project, and continue to support and monitor the Erroneous Transfer Charter[45].

2.82. Ofgem will continue to consult with customer groups and suppliers to ensure that the regulation of gas and electricity sales and marketing continues to promote practices that ensure customers do not develop negative perceptions of the switching process in the future.

Reasons for switching or not switching

2.83. Switching is an important indicator of the effectiveness of supply competition and Ofgem is therefore interested to know what the main factors that drive switching are. Analysis in Chapter 3 of this review identifies price as a significant determinant of switching. It also identifies other factors that could influence customer switching decisions.

Gas

2.84. Table 2.21 identifies the main reasons for why gas customers switched their supplier.

Table 2.21: What were the main reasons for leaving your previous gas supplier? (Top 5 responses in 2003, multiple responses allowed, not prompted)

Response (%)	2001	2002	2003
Price/Cost	64	62	65
Persuaded by salesman	7	7	8
Convenience of having one supplier - Gas/Electricity	5	6	6
Better customer service	4	8	6
Moved area	2	2	4

Source: J.D. Power and Associates

[45] The Erroneous Transfer Charter is an agreed mechanism for returning erroneously transferred customers to their original suppliers. It was fully implemented in February 2002. Ofgem's most recent review (in October 2003) showed that there had been a decrease in the number of complaints to energywatch and some overall improvement in returning erroneously transferred customers. Ofgem will continue to monitor the success of the Charter. Suppliers have also introduced a voluntary compensation scheme so that if standards are not met, customers will receive £20 compensation.

2.85. Price is the single most stated reason for customers leaving their previous supplier, with other factors such as customer service and convenience a factor for only a small proportion of customers[46].

2.86. Table 2.22 shows that for customers who have not switched, price is also the greatest factor influencing the decision. A large number simply do not want to change supplier[47]. However a significant proportion (21 per cent in 2003) say that they have not switched because of concerns about supply quality and reliability. It is therefore possible that customers think that their supplier is responsible for 'network' related services which are actually provided by National Grid Transco (NGT).

Table 2.22: What were the main reasons for staying with your current gas supplier?[48] (Top 5 responses in 2002, multiple responses allowed, not prompted)

Response (%)	2001	2002
Price/cost	30	33
Didn't want to change	18	28
Power/supply quality and reliability	15	21
Satisfied with current supplier	3	10
Better customer service	13	9

Source: J.D. Power and Associates

2.87. Table 2.23 identifies the proportion of customers who have ever switched, nationally, and by key demographic breakdowns.

Table 2.23: Proportion of customers who have ever switched in gas: key demographic breakdowns.

Demographic categories	2001	2002	2003
All domestic gas customers	37	39	47
Payment type			
Direct Debit	43	44	54
Standard Credit	32	36	40

[46] In 2001 MORI found that 68 per cent of customers switched for cheaper prices.
[47] In 2001 MORI found that 72 per cent of non-switchers "saw no reason to change/satisfied with current supplier".
[48] This question is not included in the 2003 survey.

Prepayment	34	29	32
Don't know/other	n/a(sample < 100)	n/a(sample < 100)	n/a(sample < 100)
Income			
< £10,000	44	37	45
£10,000 - £25,000	39	40	53
£25,000 - £49,999	37	47	50
£50,000 +	61	47	51
Don't know	28	36	42
Refused	no category	33	39
Social Grouping			
AB	33	49	48
C1	34	41	48
C2	40	36	52
DE	41	36	42
Refused	n/a(sample < 100)	n/a(sample < 100)	34
Region			
England and Wales	n/a	40	47
North of Scotland	n/a	30	45
South of Scotland	n/a	31	38
Age			
< 25	n/a(sample < 100)	n/a(sample < 100)	n/a(sample < 100)
25-34	37	37	49
35-44	42	47	54
45-54	41	39	51
55-64	40	33	41
65 +	28	40	42
Don't know/refused	n/a(sample < 100)	n/a(sample < 100)	n/a(sample < 100)

Source: J.D. Power and Associates

2.88. Table 2.23 illustrates that in 2003, almost half of all gas customers have switched supplier (47 per cent). The proportion of gas prepayment customers who have ever switched their supplier is 32 per cent. This is significantly below the proportions for other payment types. The proportion of direct debit customers who have ever switched is significantly above the other payment types. The proportion of customers in social group DE who have switched (42 per cent) is slightly below the national average.

Electricity

Table 2.24: What were the main reasons for leaving your previous electricity supplier? (Top 5 responses in 2003, multiple responses allowed, not prompted)

Response (%)	2001	2002	2003
Price/cost	72	70	65
Convenience of having gas and electricity with one supplier	6	7	9
Persuaded by salesman	7	6	6
Better customer service	4	4	6
Moved area	2	2	4

Source: J.D. Power and Associates

2.89. Customers who have switched cite price factors as the most important reason for changing supplier (65 per cent in 2003)[49].

Table 2.25: What were the main reasons for staying with your current electricity supplier?[50] (Top 5 responses in 2002, multiple responses allowed, not prompted)

Response (%)	2001	2002
Price/cost	27	33
I didn't want to change	19	24
Power quality or reliability	7	15
Satisfied with current supplier	3	9
Better customer service	7	9

Source: J.D. Power and Associates

2.90. Table 2.25 shows that in electricity, price/cost is stated by 33 per cent of customers in 2002 and 27 per cent in 2001 as the main reason for not leaving their electricity supplier[51].

2.91. However, the weighting of the factors changed between years. Power quality or reliability, and satisfaction with current supplier gained importance in 2002 compared to 2001, with more than double the proportion stating these as the main reasons not to switch supplier. Although the number of customers citing

[49] In 2001 MORI found that 79 per cent of electricity customers switched for cheaper prices.
[50] This question was not asked in 2003.
[51] In 2001 MORI found that 79 per cent of non-switchers "saw no reason to change/satisfied with current supplier".

quality or reliability as a factor for not switching is lower than in gas, it is possible that customers think that their electricity supplier is responsible for 'network' related services which are actually provided by a separate distribution company.

2.92. Table 2.26 identifies the proportion of electricity customers who have ever switched, nationally and by key demographic breakdowns.

Table 2.26: Proportion of customers who have ever switched in electricity: key demographic breakdowns.

Demographic categories	2001	2002	2003
All domestic electricity customers	37	43	51
Payment type			
Direct Debit	44	50	59
Standard Credit	35	42	48
Prepayment	23	31	39
Don't know/other	n/a (sample < 100)	n/a (sample < 100)	n/a (sample < 100)
Income			
< £10,000	33	44	50
£10,000 - £25,000	40	45	55
£25,000 - £49,999	41	48	58
£50,000 +	40	46	51
Don't know	29	38	45
Refused	no category	38	47
Social Grouping			
AB	36	46	52
C1	40	44	53
C2	40	46	53
DE	33	39	49
Refused	n/a(sample < 100)	n/a(sample < 100)	46
Region			
England and Wales	n/a	44	52
North of Scotland	n/a	32	36
South of Scotland	n/a	41	52

Age			
<25	n/a(sample<100)	n/a(sample<100)	n/a(sample<100)
25-34	40	42	54
35-44	40	46	57
45-54	39	43	48
55-64	36	44	54
65+	33	43	49
Don't know/refused	n/a(sample<100)	n/a(sample<100)	n/a(sample<100)

Source: J.D. Power and Associates

2.93. Table 2.26 illustrates similar trends to gas - over half (51 per cent) of all electricity customers have switched their supplier. However a significantly lower proportion (39 per cent) of electricity prepayment customers have switched. The proportion of customers in social group DE who have switched (49 per cent) is very close to the national average.

Summary

2.94. Customers say that price is the main reason for switching – and for not switching. Many non-switchers simply do not want to switch. However a relatively high proportion of non-switchers may be unaware that power quality and reliability are not issues that can be influenced by a supplier but are the responsibility of a separate network operator.

2.95. Ofgem's Corporate Plan for 2004 - 2007[52] proposes to complete research on the role of brand independence in securing effective separation of supply and distribution services. Ofgem wants to assess whether common brands for retail and network businesses are reinforcing customers' beliefs that the affiliated retail business will provide a more reliable service. This research will help to inform Ofgem whether there is a need for further work on this issue. Ofgem will also consider whether additional information should be provided to customers about the separation of supply and distribution/transportation.

[52] Ofgem Proposed Corporate Plan 2004-2007. Ofgem 59/04 March 2004

Contact with suppliers

2.96. This section examines information about the different ways that suppliers contact customers in order to try to persuade them to switch.

Gas

2.97. Table 2.27 identifies the proportion of customers who have been contacted by sales agents trying to get them to change their supplier. This question was only asked in the 2002 and 2003 J.D. Power and Associates' customer surveys.

Table 2.27: Have you ever been contacted by salespeople trying to get you to change your gas supplier? (asked only of those aware they can change their supplier)

Demographic categories	2002	2003
All domestic gas customers	90	86
Payment type		
Direct Debit	88	87
Standard Credit	91	86
Prepayment	93	82
Other	n/a (sample <100)	n/a (sample <100)
Income		
<£10,000	90	90
£10,000 - £25,000	93	86
£25,000 - £49,999	93	84
£50,000+	87	87
Don't know	89	88
Refused	84	82
Social Grouping		
AB	91	87
C1	88	83
C2	90	89
DE	92	88
Refused	n/a (sample <100)	n/a (sample <100)
Switchers		
switcher	92	91
non-switcher	88	81
Region		
England and Wales	91	86

North of Scotland	82	83
South of Scotland	85	85

Source: J.D. Power and Associates

2.98. Of those customers who are aware of competition a large majority had been contacted by sales agents[53]. The results show that the proportion of prepayment customers who have been contacted by sales agents has fallen from 93 per cent in 2002 to 82 per cent in 2003. The reduction in the proportion of prepayment customers having been contacted by a supplier could be explained by a change in the marketing strategies of suppliers. It is also possible the result may have arisen through sampling variation.

2.99. Of all customers who had been contacted, 62 per cent said that they had been contacted at home (presumably through door step sales agents) and 29 per cent said that they had been contacted by telephone. Table 2.28 illustrates these results, which confirm that doorstep sales activity continues to be the most important means of contact between suppliers and customers.

Table 2.28: On the last occasion a gas sales person contacted you, how did they make contact?

	2003
Telephone	29
Post	2
Email	0*
Called at home	62
In street/shopping mall	6
Other	0*

Source: J.D. Power and Associates * less than 1 per cent

Electricity

2.100. Table 2.29 shows that of those electricity customers who are aware of competition, a large majority had been contacted by sales agents. There is not a great difference (either by customer groups or over time) except in the North of Scotland, where the proportion is significantly below the national average. This could be because fewer households in this area have gas (and therefore suppliers

[53] In 2001 MORI found that 61 per cent of all gas and electricity customers had been contacted by a

cannot market dual fuel) or because in some areas properties are far apart, making it uneconomic to employ sales agents. However customers in the South of Scotland are more likely than the national average to have been contacted by an electricity sales agent.

Table 2.29: Have you ever been contacted by salespeople trying to get you to change your electricity supplier?

Demographic categories	2002	2003
All domestic electricity customers	88	84
Payment type		
Direct Debit	88	85
Standard Credit	88	81
Prepayment	87	88
Other	n/a (sample < 100)	n/a (sample <100)
Income		
<£10,000	87	87
£10,000 - £25,000	89	85
£25,000 - £49,999	87	82
£50,000+	91	79
Don't know	88	83
Refused	90	85
Social Grouping		
AB	87	81
C1	88	84
C2	89	86
DE	88	86
Refused	n/a (sample <100)	76
Switchers		
switcher	90	88
non-switcher	86	80
Region		
England and Wales	89	84
North of Scotland	79	72
South of Scotland	82	86

Source: J.D. Power and Associates

2.101. Table 2.30 shows that of those customers who had been contacted, 57 per cent said that they were contacted at home (presumably by a doorstep sales agent) and 34 per cent said that they were contacted by telephone. The table illustrates the continuing importance of doorstep sales agents as the main channel for contacting customers.

Table 2.30: On the last occasion an electricity sales person contacted you, how did they make contact?

	2003 (%)
Telephone	34
Post	2
Email	0*
Called at home	57
In street/shopping mall	6
Other	1

Source: J.D. Power and Associates * Less than 1 per cent

Summary

2.102. Most customers have been contacted by a gas or electricity supplier. However some groups (gas prepayment customers and those in the North of Scotland) are less likely than the average to have been contacted.

2.103. Most of the supplier contact has been through doorstep sales, although an increasing number of customers report having been contacted through telesales. This result could be indicative of telesales emerging as the main alternative channel for contacting customers.

3. Switching assessment

3.1. This chapter examines several issues concerning customers' switching behaviour. It starts by explaining the importance of understanding the choices customers make when they switch and outlines some research that Ofgem has commissioned into customer behaviour. Key statistics on switching are presented and the key findings of the research are then discussed.

Background

3.2. A customer's ability to choose between alternative suppliers is a key feature of any competitive market. Domestic gas and electricity customers are normally offered standard contractual terms and conditions by suppliers and are not able to negotiate their contracts on an individual basis. The ability to choose between alternatives offered by suppliers is therefore of particular importance to the development of competition for these customers.

3.3. Concerns have been expressed about the number of customers that have never switched away from either BGT or their ex-PES and who may not therefore have benefited to the same extent as customers who have switched. In addition, a number of customers have switched back to BGT the ex-PES and are likely to be paying more than if they had not done so. These facts, amongst others, mean that it is important to understand both the extent of switching activity as well as the reasons that drive switching behaviour.

3.4. Measures of switching activity indicate the extent of customer movement between suppliers and they therefore provide an important insight into the development of competition. Domestic reviews have in the past included a consideration of gross and net switching patterns, trends in multiple switching and switching flows[54]. However this way of measuring competition has limitations. It cannot identify whether the benefits of competition are widely shared among different types of customers. Furthermore, it does not show the extent to which customers may have benefited from switching supplier, nor does it indicate whether the competitive pressures on BGT or the ex-PESs are

[54] The gains and losses made by suppliers over a given period.

sufficient to offset any advantages they may have gained because of their original monopoly position and, in particular, whether new entrants play a role in constraining BGT or the ex-PESs' behaviour.

3.5. Examining aspects of switching behaviour other than switching numbers (for example, the reasons why customers choose to or choose not to switch and who they switch to) can therefore provide a deeper understanding of what is driving the development of domestic competition and help to direct future policy.

Terminology and data

Terminology

3.6. This section defines the concepts of switching used in this chapter, each providing a different insight into customer movement between suppliers. The Glossary at the end of this document explains other concepts that may be useful in understanding the issues raised.

- gross switching is the proportion of customers who have switched at least once. Given the increase in multiple switching, this measure replaces the gross switching indicator in previous Ofgem reviews which measured the total number of switches, including multiple switches

- net switching is the proportion of customers no longer with their ex-PES within that region (for electricity supply) or nationally with BGT (for gas supply). This indicator provides a measure of progress of competition. However, it does understate the progress of competition as it does not account for customers regained by BGT or the ex-PESs. The inverse of net switching is the BGT or ex-PES market share for gas and electricity respectively

- multiple switching refers to those customers who have changed supplier more than once. This indicator is a means of assessing the extent to which customers are willing to continue to seek savings through switching

- gains and losses provide a more detailed understanding of switching activity since they identify the magnitude of customer movement to, as well as away from a supplier. The result of these customer flows is a net fall or

rise in customer numbers with a supplier over a period of time. Underlying gains and losses can therefore indicate market activity not apparent from other aggregate measures

- switching cost is an economic concept that refers to the costs incurred by customers in finding and switching supplier. Switching costs are classified into a variety of categories, including: transaction costs, contractual costs, uncertainty costs, psychological costs, shopping costs and search costs (see the Glossary for a more detailed explanation of these costs). In addition to the above types of customer switching costs, firms can also incur costs when customers switch supplier, and

- entrant – an entrant in the gas supply sector refers to all non-BGT suppliers, including the ex-PESs. In the electricity sector, where each region was supplied by a single supplier (PES) prior to market opening, an entrant is defined as suppliers including BGT and the ex-PESs of other regions.

Ofgem's data

3.7. Ofgem monitors switching on a monthly basis. Electricity suppliers report their total customer numbers in Great Britain and distribution companies provide customer numbers by supplier in each of their respective regions. These reports also provide the number of customers gained in a given month. Gas suppliers provide their customer numbers together with their gains and losses for each month.

Definition of a 'switch'

3.8. There are a variety of ways in which switching could be measured. This section explains the ways in which Ofgem has assessed switching activity for the purposes of this review.

3.9. Switching is the conclusion of a decision to receive supply of gas or electricity from an alternative supplier. Unlike in many other industries, this process involves a complex procedure through central registration systems so that the supplier responsible for an individual meter is known. The successful conclusion of this process is the customer's registration with a new supplier. A 'switch' therefore has to include a change of supplier; Ofgem's definition does not

include decisions such as choosing an alternative tariff or an alternative form of payment unless there is also a change of supplier.

3.10. Customers who move and continue receiving their gas or electricity from the previous occupant's supplier are not counted as switchers since the supplier to the property has not changed.

3.11. The development of dual fuel offerings can give rise to situations where customers choose to continue to take supply of one fuel from their current provider and switch their other fuel to that supplier. In this instance only a single switch would have occurred since only one fuel is supplied by a new supplier. Where both fuels are supplied by a new supplier, a switch in each fuel will have occurred, which constitutes two switches (one in each fuel) rather than a single switch.

Key facts and trends

3.12. The main points arising from analysis of trends in customer movement are:

- gross switching continues to rise - 47 per cent of gas customers and 51 per cent of electricity customers have now switched at least once
- net switching (non-incumbent share of customers) is at 39 per cent for both gas and electricity[55]
- by the end of 2003, of those who had switched supplier, 39 per cent of gas customers and 34 per cent of electricity customers had changed their supplier more than once
- substantial two-way movement of customers between suppliers underlies a slower net change in supplier customer numbers, and
- of the 3.1m gas customers that switched in 2003, 42 per cent moved away from BGT and of the 4.2m electricity switchers over the same period, 44 per cent moved away from their ex-PES.

3.13. The main points arising from the examination of switching behaviour are:

- that prices do drive switching rates, but there are significant differences in switching rates between suppliers that are not explained by price. These "fixed effects" play a significant role in switching. They are different between suppliers and are greatest for the ex-PESs and BGT, and

- the analysis found no significant relationship between social class or tenure and a decision to switch.

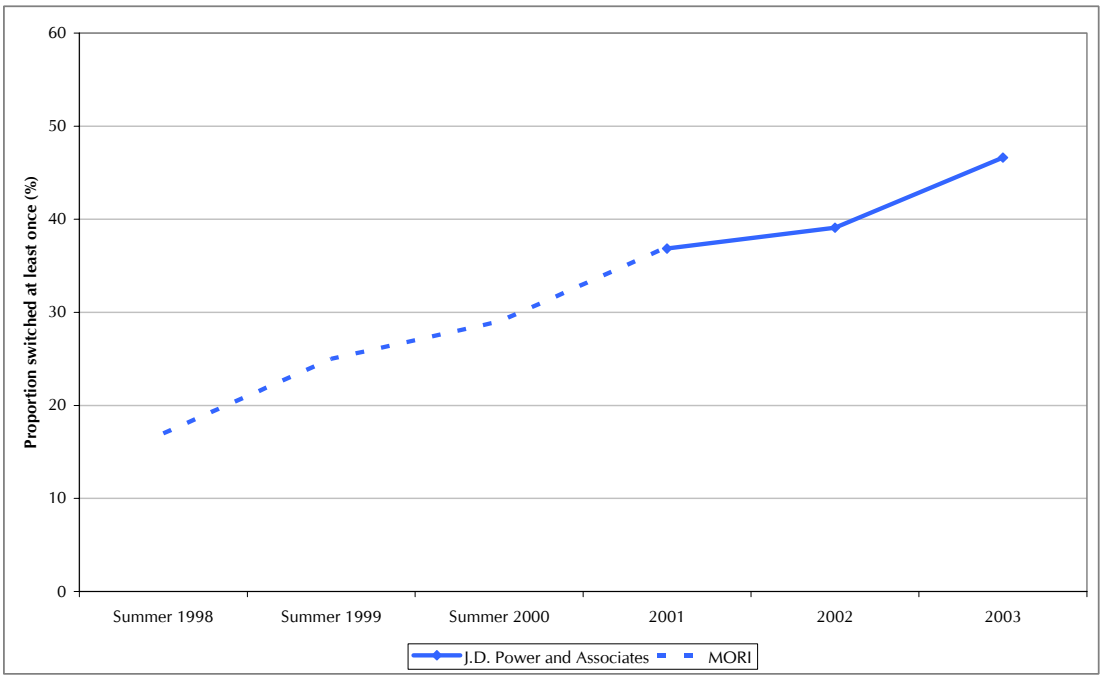
Analysis

Gross Switching

3.14. Figures 3.1 and 3.2 illustrate trends in national gross switching for gas and electricity, which both show that gross switching continues to increase. According to survey data, by the end of 2003, 47 per cent of customers had switched their gas supplier at least once. In electricity, the equivalent proportion is 51 per cent.

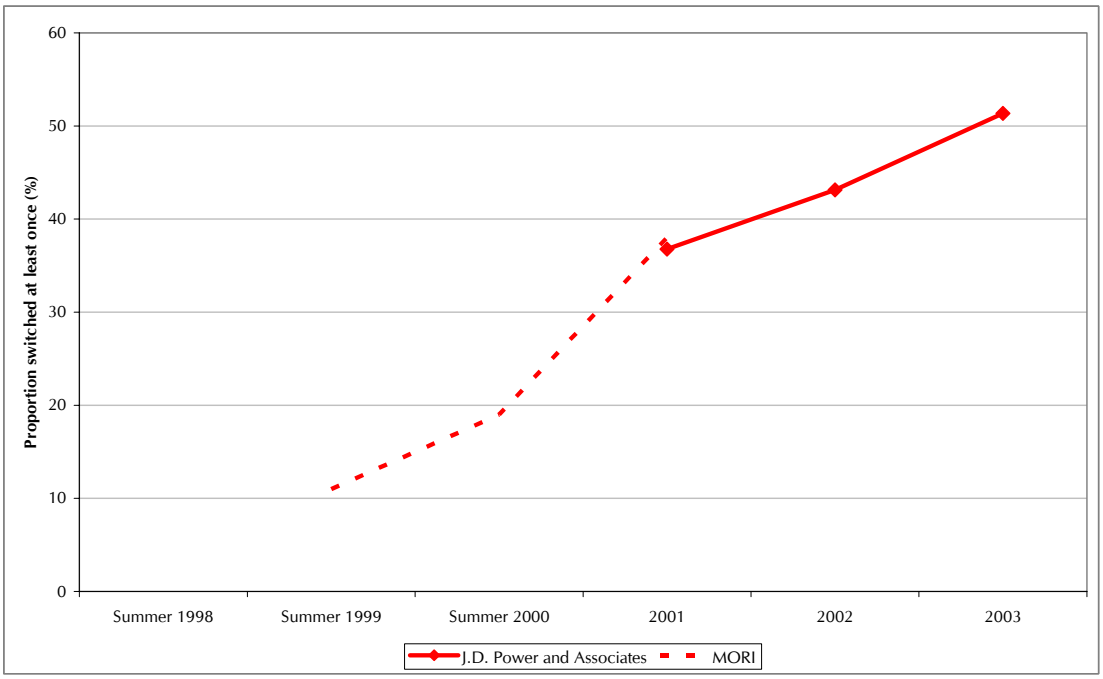
[55] Consistent with incumbent electricity supplier defined on the basis of 'Group' in Table 6.2

Figure 3.1: Gas: Gross switching



Source: MORI, J.D. Power and Associates[56]

Figure 3.2: Electricity: Gross switching



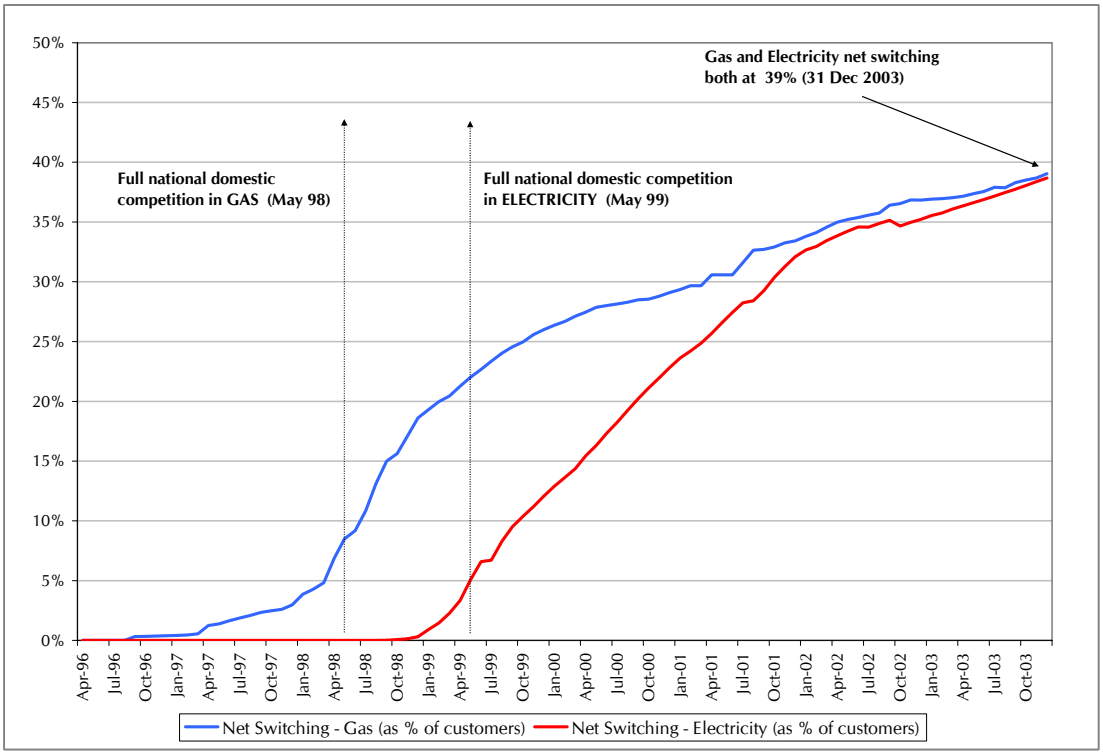
Source: MORI, J.D. Power and Associates[59]

[56] The gross switching figure for summer 2000 is weighted based on Ofgem's estimation of switching rates as opposed to that for 2001 which is not, as MORI has suggested that the figure for 2000 represents an underestimate of the actual gross customer switching.

Net switching

3.15. Figure 3.3 shows the extent of net switching since the introduction of competition in gas and electricity to the end of 2003. The percentage of total customers no longer with BGT or their ex-PES supplier (that is new entrant market share) continues to rise, albeit at a slower rate, reaching 39 per cent in both gas and electricity.

Figure 3.3: Long term net switching in gas and electricity



Source: Gas: Transco and Gas Suppliers, Electricity: Distribution companies

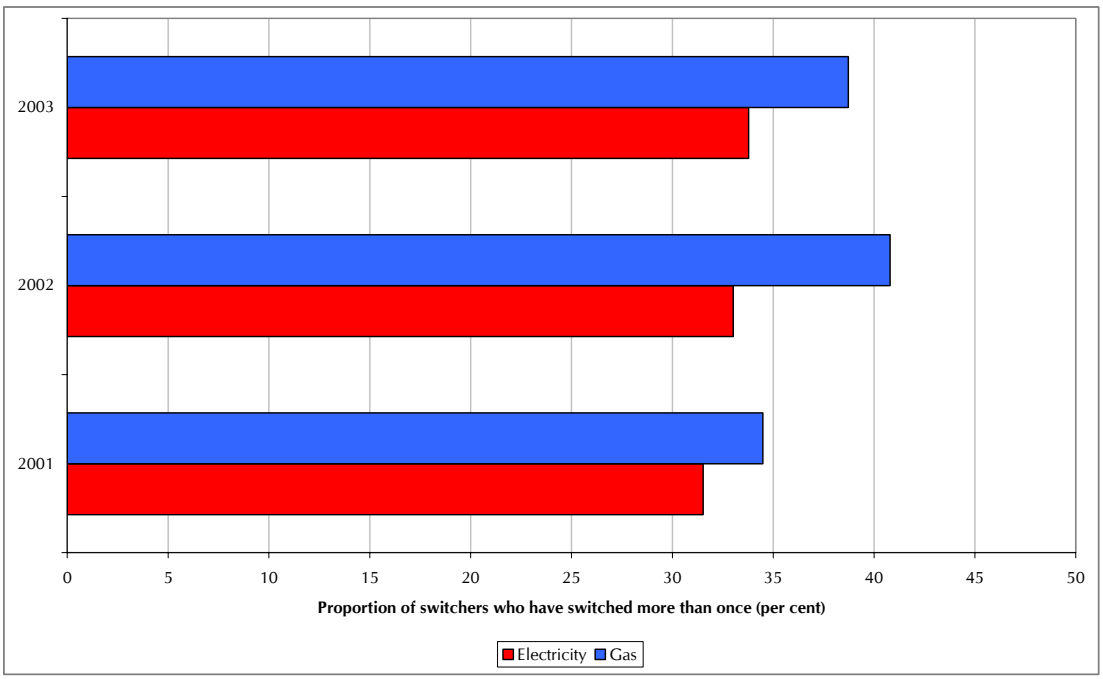
Multiple switching

3.16. Figure 3.4 illustrates the share of switching accounted for by multiple switchers over the period 2001 to 2003 based on the J.D. Power and Associates' surveys. Multiple switchers are defined as those who have switched more than once and are represented here as a percentage of those who have ever switched (gross switchers). Figure 3.4 shows that multiple switching is increasing at a faster rate and is larger in absolute value in gas compared to electricity[57]. The evidence in Figure 3.4 therefore suggests that there are a proportion of customers who are

[57] Sampling error is evident in Figure 3.4 in that the proportion of multiple switchers in gas is larger in 2002

fairly fluid in their ability to change supplier, although the majority of switchers are first time switchers.

Figure 3.4: Electricity and Gas: Multiple switching



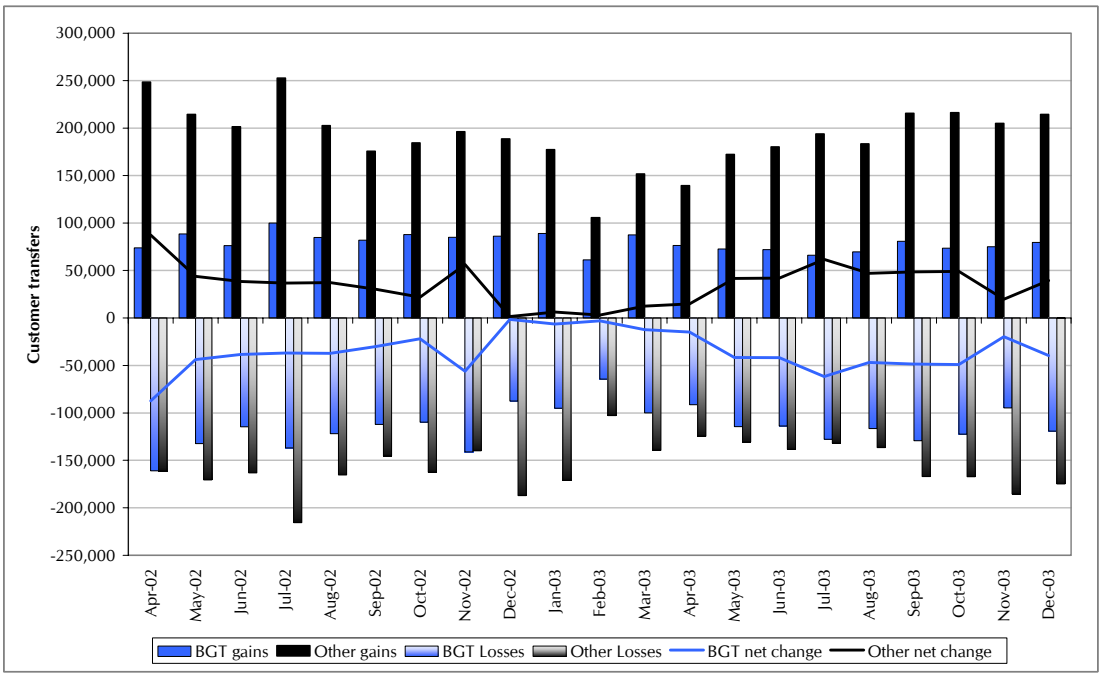
Source: J.D. Power and Associates

Gains and losses

Gas

3.17. Figure 3.5 shows the underlying losses and gains by BGT and other suppliers in each month between April 2002 and December 2003, and Figure 3.6 for 2003, illustrating how net switching rates are generally underpinned by a substantial two way movement of customers between BGT and competing suppliers. The bars below the horizontal axis represent customers lost to BGT or other suppliers, while the bars above the horizontal axis represent customers gained by BGT or other suppliers. Since all customers were with BGT prior to competition, BGT gains must represent multiple switchers who have returned to BGT.

Figure 3.5: Gas switching flows

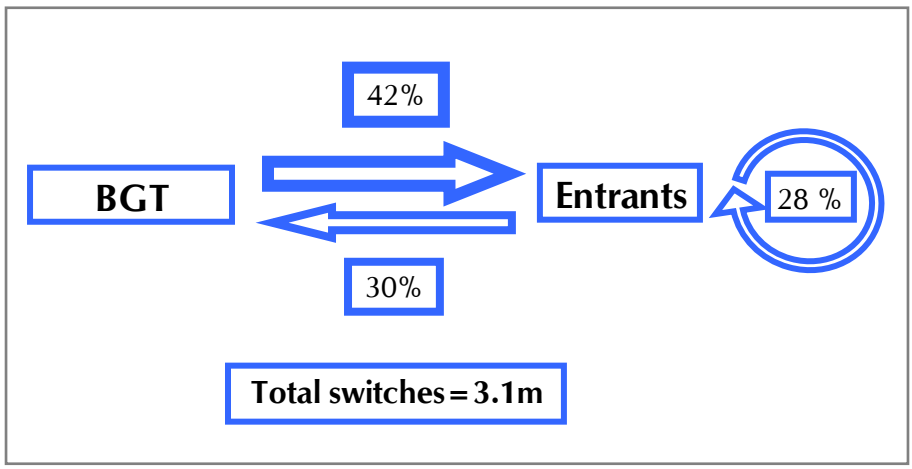


Source: Gas Suppliers

3.18. The line below the horizontal axis in Figure 3.5 represents the aggregate net movement of customers away from BGT in each month. The net loss of customers away from BGT was 0.4m in 2003.

3.19. During 2003, 3.1m customers changed their gas supplier. Figure 3.6 illustrates the flow of these customers between BGT, and entrants to the gas market. The diagram shows that 42 per cent of all gas switching involved customers leaving BGT, whilst 30 per cent of switching activity were BGT 'winbacks'. The diagram also shows that 28 per cent of total gas switching activity was between the entrants.

Figure 3.6: Gas customer switching flows between BGT and entrants during 2003

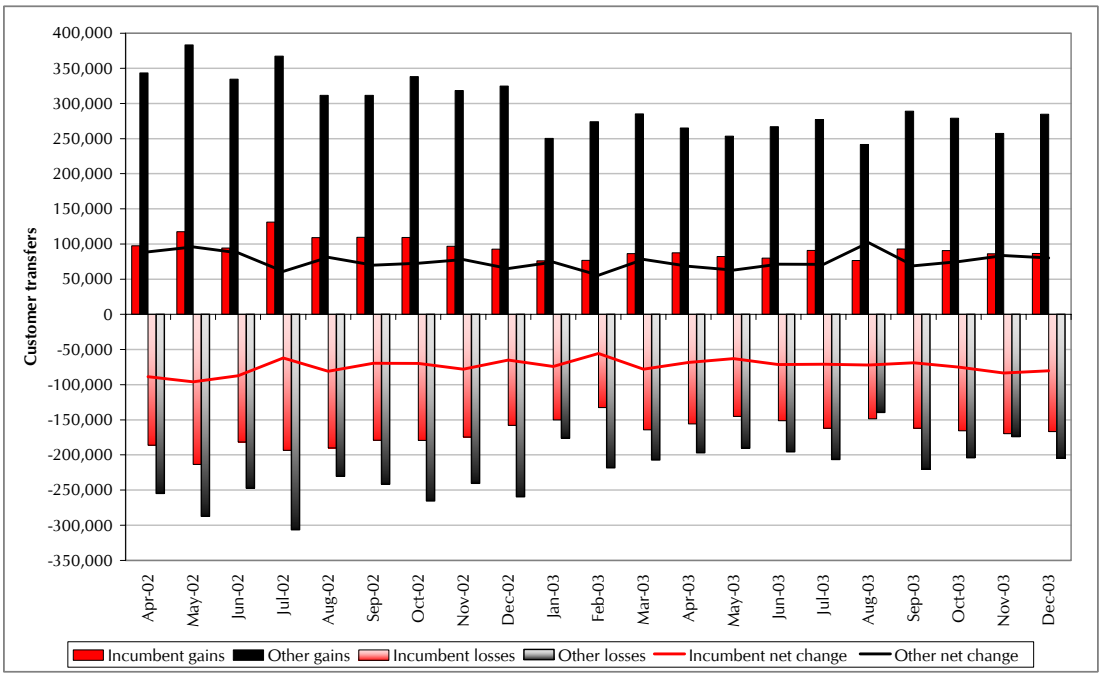


Source: Gas suppliers

Electricity

3.20. Figure 3.7 illustrates the aggregate in-area gross gains and losses for all the ex-PESs in each month since April 2002. The bars below the horizontal axis represent switchers who are transferring away from other suppliers or the ex-PES in their region, while the bars above the horizontal axis represent customers acquired by other suppliers or the ex-PES in their region. Since all domestic electricity customers were with their ex-PES before competition, ex-PES gains represent multiple switchers who have returned to the ex-PESs.

Figure 3.7: Electricity: Gains and Losses



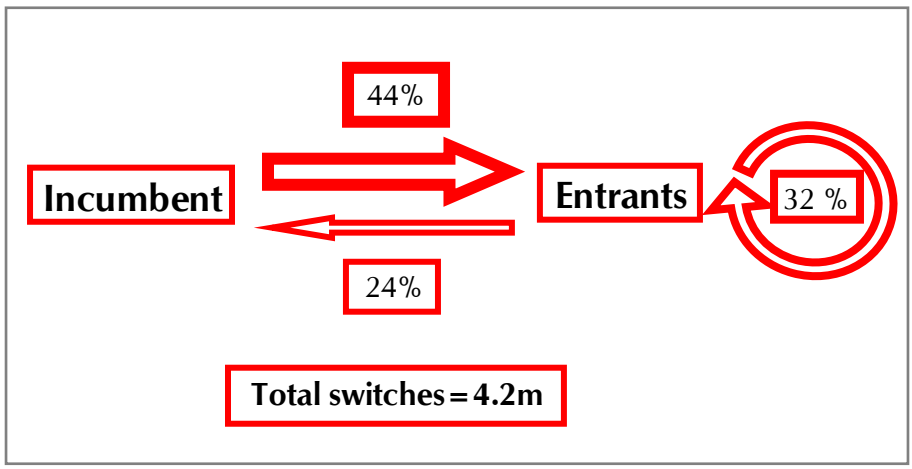
Source: Distribution companies

3.21. The line below the horizontal axis represents the aggregate net movement of customers away from the ex-PESs in each month. The net loss of customers away from ex-PESs was 0.85m in 2003. Figure 3.7 shows that ex-PES net losses have been relatively static since April 2002, as losses continue to outweigh gains on average by around 70,000 each month[58].

3.22. During 2003, 4.2 million customers changed their electricity supplier. Figure 3.8 shows the flow of these customers between ex-PESs and entrants[59]. The diagram shows that 44 per cent of all electricity switching was accounted for by customers leaving an ex-PES, whilst 24 per cent of switching activity arose from ex-PES 'winbacks'. The diagram also shows that 32 per cent of total electricity switching activity was between the entrants.

[58] The line above the horizontal axis represents net gains by 'others', and nets off 'others losses' (shaded bars below the horizontal axis) from 'others gains' (filled bars above the horizontal axis).
[59] In electricity, a regional view of incumbents is taken, and therefore the incumbent can be a different supplier in each region.

Figure 3.8: Electricity customer switching flows between ex-PESs (in area) and entrants during 2003



Source: Distribution companies

3.23. Figures 3.7 and 3.8 illustrate that while net switching rates are increasing slowly, this masks an environment in which significant customer gains and losses occur. In the absence of winbacks, the erosion of BGT and ex-PESs customer shares would be significantly greater than the current rate[60].

3.24. In comparing the former ex-PESs and BGT, the switching flows over 2003 suggest that BGT has been more successful in winning back customers than the electricity ex-PESs. The analysis also shows that over the period observed, entrant gains are consistently larger than ex-PES or BGT losses in the electricity and gas sectors respectively. With ex-PES or BGT gains consistently smaller than entrant losses in the respective sectors, this implies that a significant amount of transfers occurred between entrant suppliers in both the gas and electricity sectors in 2003.

Research into factors influencing switching decisions

3.25. This section explains some research that has been conducted for Ofgem into the factors influencing customer switching. Several factors are likely to influence a customer's decision to change supplier. These may include:

- the level of benefits available from switching supplier[61]

[60] In September 2003, Ofgem announced its decision following an investigation into LE Group's winback offers and will continue to respond to complaints in this area.
[61] This will include monetary saving plus any value a customer places on a non-price offer. Non-price offers

- whether these benefits outweigh the customer's switching costs
- other things being equal, the higher the perceived savings customers may make at any given time, the more likely it is that they will switch supplier
- customers may not exhaustively search to maximise their net benefit from switching if they cannot easily identify whether there is a better offer than the one they are considering
- switching costs may be related to factors not specific to the sector[62]
- in deciding to switch away from the ex-PESs or BGT, customers may not take into account the same factors that they do when they decide to switch away from new entrants, and
- some customers may form an expectation that their ex-PES or BGT would react to competition by lowering prices, and make choices based on the belief that the benefits of competition may be acquired without incurring the switching costs.

3.26. The interaction between switching benefits and costs may also vary:

- over time as suppliers increase or decrease their sales activity, enter and exit regions or change other elements of their offers
- each time the customer switches and learns more about the process, the offers available and how they might assess these, and
- customers who have not switched may become more aware of the possibilities through friends, media and general publicity, while their personal circumstances may also change (for example by moving house).

3.27. In this context Ofgem has sought to further develop its understanding of why some customers do not switch. In particular, given concerns expressed about the number of customers who have not yet switched supplier, and that ex-PESs and

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are discussed in further detail in Chapter 4.

[62] The research paper by Monica Giulietti, Catherine Waddams Price and Michael Waterson, *Redundant Regulation? Competition and Consumer Choice in Residential Energy Markets*, November 2000, provides some evidence that household willingness to change supplier in one sector may have a strong positive relationship with the decision to do so in another sector.

BGT generally charge more than other suppliers in those areas where they previously held a monopoly in supply, Ofgem has sought to establish:

- whether all customers are benefiting from competition. If it seems that they are not, whether Ofgem should develop targeted policy initiatives towards those customers, and
- an insight into the competitive pressures faced by suppliers and to try to understand whether these are similar for all suppliers.

Data

3.28. Given the complexity of the potential interactions of these factors, Ofgem commissioned Frontier to analyse various information and provide insights into switching behaviour. Frontier analysed gross gains in gas customers made by suppliers over the period September 1998 to August 2003[63] in order to examine the relative importance of price as well as other factors and their influence on customer switching to a particular supplier. These results are presented in further detail in Appendix 2.

3.29. Frontier also used Ofgem's transfer data and pricing information to analyse gross gains in electricity customers by suppliers over the period May 2002 to August 2003. Gross switching in the domestic electricity sector is more complex than in domestic gas since there is a significant regional element in electricity, a shorter time period for which data is available and little variation in regional prices. The results for electricity are therefore less conclusive, but are similar to those found in the gas sector. These are presented in further detail in Appendix 3.

Main Findings

3.30. Although there were some differences in the results for gas and electricity, Frontier's main findings were:

- prices do drive switching rates, but there are significant differences in switching rates between suppliers that are not explained by price (these are referred to in this chapter as "fixed effects")

- these fixed effects play a significant role in switching, they are different between suppliers and are greatest for the ex-PESs and BGT
- there is insufficient evidence to identify whether these fixed effects are competitively acquired or are a legacy of the supplier's status as a former monopoly
- some demographic factors are associated with higher switching rates than others
- the dual fuel proposition marketed by direct selling (particularly doorstep selling) has had a significant influence on switching behaviour, and
- non-switchers are less sensitive to price than switchers.

3.31. The following sections discuss these findings in more detail.

Gas

3.32. The analysis compared gross gains by supplier to changes in prices over a period of time to see how price changes affect switching. The resulting relationship is set out with the formal specification and further detail provided in Appendix 2.

3.33. The results of this analysis suggest that while price is a key element in domestic customers' decision to switch suppliers, fixed effects also play an important role in the decision. In addition, suppliers differ materially in their ability to attract customers through these fixed effects factors.

Fixed effects

3.34. Although the study was not able to identify separately the role of individual fixed effects, collectively they were found to play a role in suppliers' ability to attract domestic customers. In particular, BGT and the ex-PES suppliers appear to benefit to a greater extent from these factors compared to other gas suppliers.

3.35. Figure 3.9 illustrates the relative strength of these factors between supplier brands. The graph represents the ability of suppliers to attract new customers on

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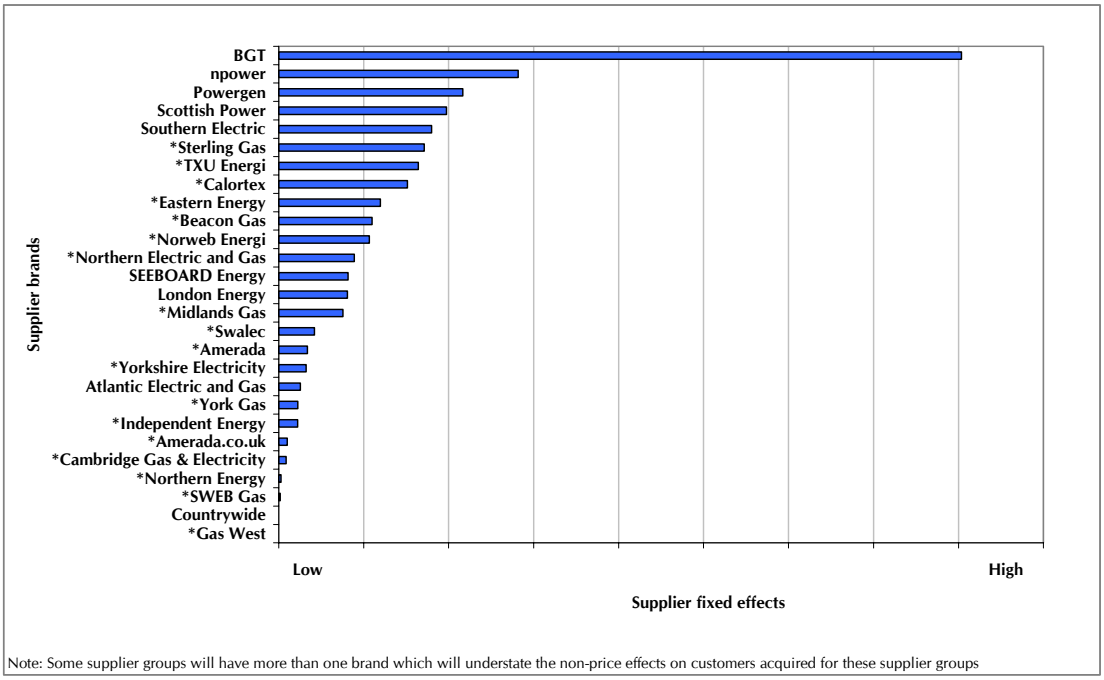
[63] The study was commissioned prior to the end of 2003 when finalised data only to end of August 2003 was available. This also applies for the electricity customer analysis.

the basis of factors not explained by differences in their prices. It illustrates that fixed effects associated with the BGT and the ex-PES supplier brands are generally larger than those of other suppliers in the gas sector.

Figure 3.9: Estimation of the effect of fixed effects on the ability of suppliers to acquire customers – gas



Source: Ofgem research[64]

3.36. An implication of this analysis is that BGT and some ex-PES suppliers (such as Powergen and npower) are less reliant on price to acquire gas customers than entrants such as Atlantic Electric and Gas. This implies that if there were no difference in price between a supplier with a high fixed effect and a supplier with a low fixed effect, the former would get more switchers than the latter. It is therefore likely that suppliers that benefit less from these fixed effects will need to focus more on price as a means of attracting customers. This analysis is also consistent with the view that suppliers such as BGT and the ex-PESs are generally able to set their average gas prices higher than other suppliers without reducing their ability to attract customers to the same extent as some of the other suppliers.

[64] A number of gas brands listed in Figure 3.9 are no longer active and the results therefore reflect the strength of non-price factors while the brand was active. These are the suppliers with an asterisk (*) in 3.9, namely Sterling Gas, TXU Energi, Calortex, Eastern Energy, Beacon Gas, Norweb Energi, Northern Electric and Gas, Midlands Gas, Swalec, Yorkshire Electricity, York Gas, Independent Energy, Amerada, Amerada.co.uk, Cambridge Gas and Electricity, Northern Energy, SWEB Gas and Gas West.

3.37. There may be a number of explanations for these findings, including:

- customers may take account of factors other than price. For example, the ex-PESs and BGT have invested in areas such as marketing and service quality to a greater extent than other suppliers and may therefore have benefited by attracting a higher proportion of customers
- BGT and the ex-PESs may benefit from their former position as the only supplier in a given region and/or fuel, and this customer brand awareness gives them an advantage when gas customers choose between comparable price offerings, and
- BGT and the ex-PESs may be protected to some extent from price competition in gas supply because customers have difficulty getting independent price information about all the available offers. Sales initiatives such as doorstep selling, for example, may have stimulated customer switching based on insufficient information about potential savings.

Price factors

3.38. In terms of explaining the influence that gas pricing has on the extent of gains made by suppliers, a notable feature of the analysis is the significance of the role of other suppliers' discounts to BGT's prices. The analysis found a relationship between the number of customers gained by a given supplier, its own discount[65], and the average discount offered by other competing suppliers[66], relative to BGT's prices. This means that where switching is price driven, relative prices rather than absolute prices appear to be relevant in explaining switching activity. A given supplier's customer gains vary according to the savings it offers relative to BGT's price as well as the savings it offers relative to suppliers other than BGT.

[65] Suppliers increase their customers gained in any given month by around 5 per cent, by pricing at a discount to BGT of the order of 1 per cent, all other factors being constant.
[66] For a given supplier A, the greater the average discount offered by its competitors to BGT's prices, the lower the number of customers acquired by supplier A. If the average of the competing supplier discounts is 1 per cent below that of the incumbent, supplier A's gains are likely to reduce by around 4.7 per cent, all other factors being constant.

3.39. This suggests that much of the price related switching activity in the gas sector is influenced by suppliers discounting to BGT's price and implies that the pricing levels around which switching occurs are significantly influenced by the price set by BGT.

3.40. This then raises a question about what constrains BGT's price. If discounts to BGT's prices (rather than the level of BGT's prices) are a key reference point for customer switching levels, then the rate at which competing suppliers gain customers may be indifferent to whether BGT sets it prices at a competitive level or well above the competitive level.

3.41. Given the importance of fixed effects illustrated in Figure 3.9 and their potential to insulate BGT and some other suppliers from competitive pressures, Ofgem is carrying out more analysis in this area. This will include consideration of the extent to which reductions in market share may have a role in influencing price levels, and supplier responsiveness to competition in the supply sector generally.

Customer survey data

3.42. A more developed understanding of customer characteristics and their association with willingness to change supplier is possible through the use of other analytical tools.

3.43. Analysis at the household level based on information from customer surveys can identify differences in the characteristics associated with customers that have never switched and those that have.

3.44. The analysis in this section uses the household data in the J.D. Power and Associates' surveys (2001 – 2003) to examine the characteristics of switchers and non-switchers. The J.D. Power and Associates' gas surveys are telephone surveys conducted on a sample of approximately 3,000 customers each year. The surveys are conducted in mid-summer to early autumn each year. In the gas sample there are a total of 9,289 customers across the three years. Table 3.1 shows the proportion of switchers in the sample for each year of the survey.

Table 3.1: Summary of J.D. Power surveys - gas

	2001	2002	2003
Proportion who have switched in last 12 months	12%	15%	13%
Survey period	June-September	July-August	August-October
Customers	3,277	3,211	2,801

Source: J.D. Power and Associates

3.45. Of those customers who were with a non-BGT supplier at the beginning of each period, the proportion in this sample who had switched in the previous 12 months was 51 per cent. For those customers who were with BGT at the beginning of each period, the proportion was 8.6 per cent. For the combined sample, the proportion was 18.4 per cent. These three samples are discussed further below.

3.46. Given the above, it is possible that demographic factors may be related to these differences in switching rates. For example, if customers with a given demographic profile are less likely to switch, the BGT sample would be expected to have a higher proportion of these customers than the non-BGT sample.

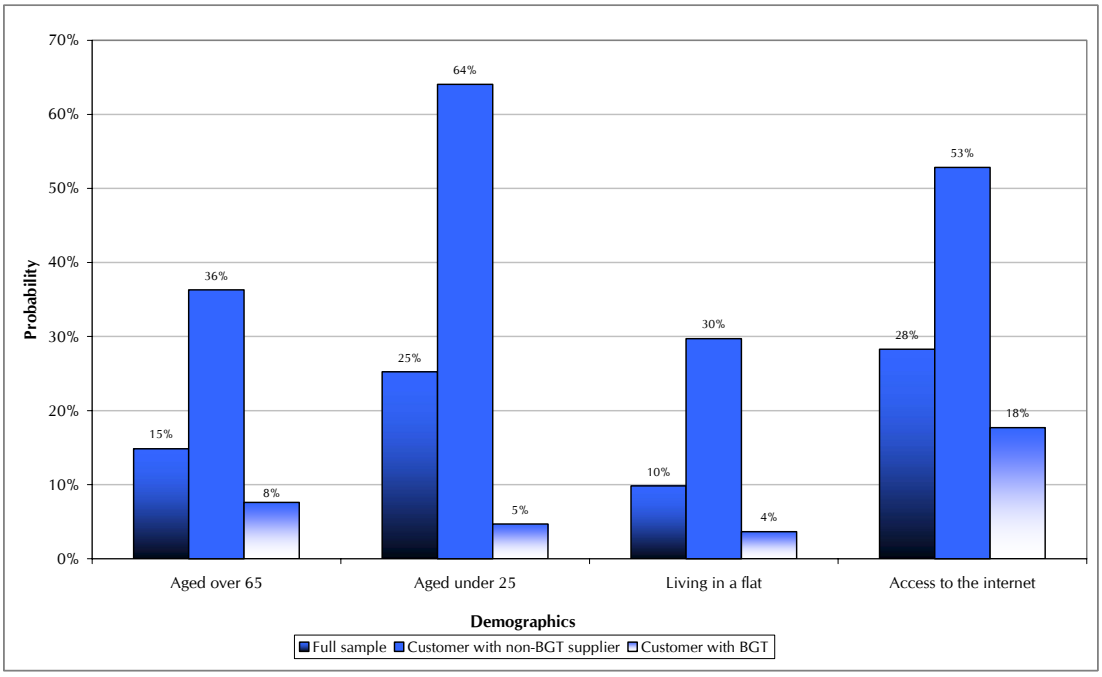
3.47. An analysis of summary statistics in the J.D. Power and Associates' surveys indicates that the BGT customer base is older than that of non-BGT suppliers and that on average BGT customers have longer tenure than those with non-BGT suppliers. In terms of nature of dwelling and whether a household has internet access, there is no obvious difference between the two samples.

3.48. A further area of interest is whether an association exists between willingness to switch and demographic factors and whether the willingness of customers to change supplier differs between the BGT and non-BGT sample for a given demographic factor. These may provide some indication of factors relevant to switching behaviour and identify variation in the strength of BGT's ability to retain customers across different demographic profiles. The analysis therefore compares the different samples to assess any such differences.

3.49. The analysis found no significant relationship between social class or tenure and a decision to switch. Figure 3.10 illustrates the probability of switching where the relationship between a given demographic factor and switching was

statistically significant. The diagram indicates that for each of these demographics the likelihood of a household changing supplier within a given 12 month period is substantially higher if a customer is with a non-BGT supplier rather than BGT. This supports the overall pattern identified in the switching flows in Figure 3.6 which indicated that the majority of switching activity in 2003 arose either from customers switching between non-BGT suppliers or back to BGT.

Figure 3.10 Probability of switching from existing supplier (gas) – by demographic



Source: Ofgem research

3.50. The results of this assessment require certain qualifications, which are also applicable to the equivalent analysis of electricity switching activity:

- the analysis identifies association rather than causality. This means that a strong relationship between switching behaviour and a given demographic does not necessarily imply that the demographic influences the switching decision
- demographics may be related (for example, older people may remain in the same property for longer), and

- demographics may represent wider factors than the factor specified[67].

3.51. A key finding of this analysis is that social class and tenure do not appear to explain differences in switching between customers. Those demographics with a statistically significant relationship with the likelihood of switching in the gas sector[68] are customers falling into one or more of the following categories:

- aged over 65
- aged under 25
- living in a flat, and
- with internet access.

3.52. Younger customers (under 25) with a non-BGT supplier generally display a higher propensity to switch – a feature not apparent in the BGT sample. This contrast in the level of loyalty between those with BGT and those with non-BGT suppliers is also evident in the over 65 age category though to a lesser extent than the younger household sample.

3.53. It is possible that customers switch for reasons that are not related to the gas or electricity sector. The variable 'access to internet' may therefore capture wider characteristics related to a household's willingness to change supplier not specific to the gas or electricity sector. Given the above and the evidence in Figure 3.10, the most significant characteristic related to a willingness to switch away from BGT may not be specific to the gas sector or the behaviour of other suppliers, but is more closely related to a customer's general willingness to seek out alternatives. This reinforces the evidence presented earlier in this chapter on aggregate switching which shows high levels of switching activity between entrants.

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[67] See earlier footnote on research paper by Monica Giulietti, Catherine Waddams Price and Michael Waterson, *Redundant Regulation? Competition and Consumer Choice in Residential Energy Markets*, November 2000.

[68] All other demographics considered had weak relationships with the decision to switch within a 12 month period.

Electricity

3.54. An equivalent approach to that described in the gas section was used to assess customer switching between competing electricity suppliers.

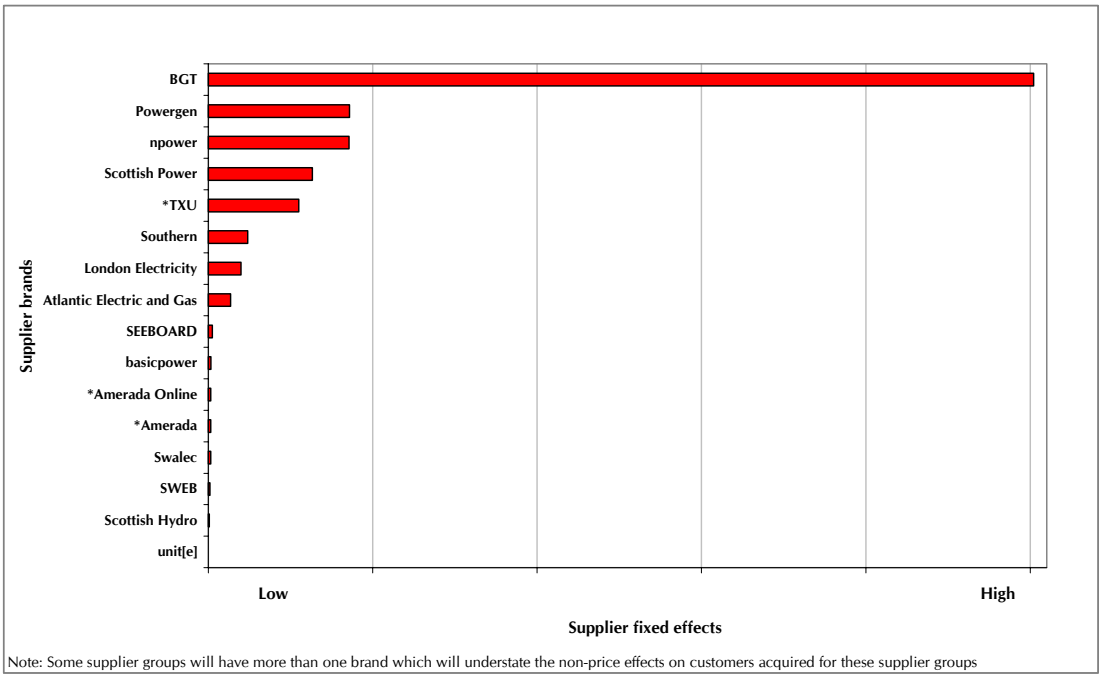
3.55. While the lack of variability in the electricity prices over the time period considered and the additional role of regional effects reduces the strength of conclusions in the electricity sector compared to that in the gas sector analysis, the results are similar to those in gas. Further detail of the analysis is presented in Appendix 3.

3.56. Prices are again seen to play a key role in domestic customers' decisions to switch suppliers, as do fixed effects, with suppliers differing materially in their ability to attract customers through these fixed effects.

Fixed effects

3.57. Figure 3.11 shows that in the electricity sector the largest suppliers, and in particular BGT, continue to have the largest fixed effects, suggesting that price competition is not as significant a factor for some suppliers as for others. In particular BGT, npower, Powergen and ScottishPower acquire a considerable proportion of their customers on the strength of fixed effects rather than price. However, mergers and acquisitions prevent consideration of the major electricity supplier groups as a single group over the relevant time period. This will tend to overstate BGT's position relative to some of the ex-PES brands and this should be taken into account when drawing inferences from these results.

Figure 3.11: Estimation of the effect of fixed effects on the ability of suppliers to acquire customers - electricity



Note: Some supplier groups will have more than one brand which will understate the non-price effects on customers acquired for these supplier groups

Source: Ofgem research[69]

Price factors

3.58. The results in Appendix 3 show similar conclusions to those in the analysis of gas switching. Much of the price related switching activity is influenced by suppliers pricing relative to the ex-PES. This implies that the pricing levels around which switching occurs are significantly influenced by the prices set by these suppliers in their incumbent region. As in gas, the analysis of electricity customer gains also raises questions about the constraint on the pricing levels of the ex-PESs in their incumbent areas. If discounts to the ex-PES price (rather than the level of ex-PES price) are a key reference point for customer switching levels, then the rate at which competing suppliers gain customers may be indifferent to whether the ex-PES sets its prices at a competitive level or well above the competitive level.

[69] A small number of brands listed in Figure 3.11 are no longer active and the results therefore reflect the strength of non-price factors while the brand was active. These are the suppliers with an asterisk (*) in 3.11, namely TXU Energi, Amerada, and Amerada.co.uk all of whom were subsumed in the Powergen brand.

3.59. In the absence of any changes in the discounts offered by other suppliers, if discounts to the incumbents' prices, rather than the level of its prices, are a key reference point for customer switching decisions, then the rate at which other suppliers gain switchers may be indifferent to whether ex-PESs price at a competitive level or well above the competitive level.

Customer survey data

3.60. The analysis in this section is equivalent to the approach described in the gas section. This uses the household data obtained from the J.D. Power and Associates' electricity surveys (2001, 2002 and 2003) to examine the characteristics of switchers and non-switchers. In the electricity sample there are a total of 13,115 customers. Table 3.2 shows the proportion of switchers in the sample for each year of the survey.

Table 3.2: Summary of J.D. Power and Associates' surveys - electricity

	2001	2002	2003
Proportion who have switched in last 12 months	20%	22%	22%
Survey period	June-August	June-July	July - August
Observations	5,009	4,505	3,601

Source: J.D. Power and Associates

3.61. For the sample of customers who were with a supplier other than the ex-PES at the beginning of the relevant period, the proportion of customers who switched within 12 months was 24.6 per cent, and for those customers who were with an ex-PES at the beginning of each period, the proportion was 16.8 per cent. For the combined sample, the probability of having switched in the last 12 months was 21.9 per cent. These three samples are examined further below.

3.62. Given the above, it is possible that demographic factors may be related to these differences in switching rates. For example, if customers with a given demographic profile are less likely to switch, the ex-PES sample would be expected to have a higher proportion of these customers than the non-ex-PES sample.

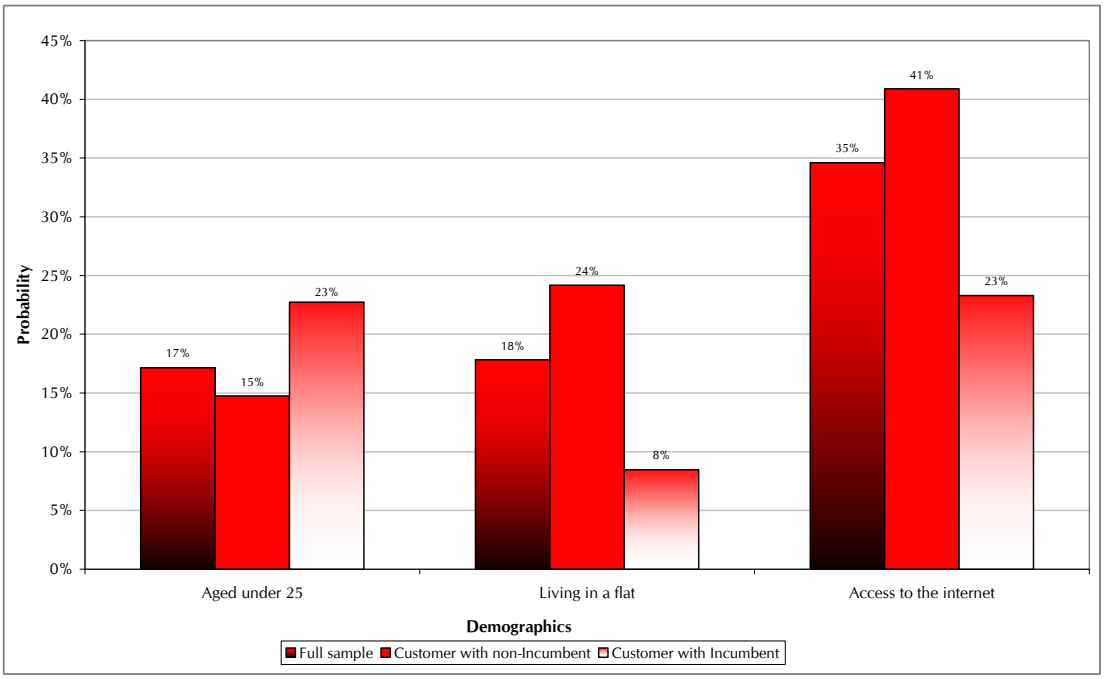
3.63. Summary statistics in the J.D. Power and Associates' surveys indicate that while the ex-PES customer base is older than that of non-ex-PES suppliers, and those

with longer tenure tend to be with an ex-PES, this difference between the incumbent and non-incumbent sample is narrower than in the gas analysis. There is no apparent difference between these two samples in respect of dwelling type or internet access.

3.64. A further area of interest is whether an association exists between willingness to switch and demographic factors and whether the willingness of customers to change supplier differs between the ex-PES and entrant sample for a given demographic factor. The analysis therefore compares the different samples to assess any such differences.

3.65. A key finding of the analysis is that no significant relationship between social class or tenure and a decision to switch was found. Figure 3.12 illustrates the probability of switching where the relationship between a given demographic factor and switching is statistically significant. This suggests that for each of the demographics shown, customers with entrant suppliers in a given region are generally more likely to change supplier within a 12 month period compared to those with the ex-PES. This is consistent with switching flows in the electricity sector, where Figure 3.8 indicated a total of 56 per cent of switches were away from the entrant suppliers during 2003. However, differences in probabilities by demographic factor between the entrant and ex-PES samples are substantially less than those observed in the gas analysis.

Figure 3.12: Probability of switching from existing supplier (electricity) – by demographic



Source: Ofgem research

3.66. As for gas, the analysis indicates that while social class and tenure were not significant in explaining switching activity, those demographics with a statistically significant relationship with the likelihood of switching in electricity are customers falling into one or more of the following categories:

- customers under 25[70]
- customers in flats, and
- customers with internet access.

3.67. In contrast to the results in gas, after taking account of the accuracy of the estimates of the model, the likelihood of a younger household (under 25) switching away from an electricity supplier was not materially different, whether or not they were currently supplied by an ex-PES. Electricity customers in flats with a non-ex-PES supplier are more likely to switch supplier than those with the ex-PES, while the same is true of homes with internet access.

[70] Unlike gas, customers classified as over 65 were not found to have a statistically significant association with the likelihood of switching.

3.68. The results for those customers with internet access are comparable to those seen in the gas sector. Of the demographics considered, where a customer is currently supplied by an ex-PES, those with internet access are most likely to switch away from that supplier. However, unlike the results in the gas analysis, internet access is not the only factor associated with a relatively high probability of switching by those in the incumbent sample, since other demographics, such as younger customers are also associated with relatively high probabilities of switching away from the ex-PES.

Supplier behaviour and dual fuel

3.69. Chapter 2 of this review discussed the different ways that suppliers contact customers in order to try to persuade them to switch supplier. That discussion indicated that doorstep sales activity remains the most important means of contact between suppliers and customers.

3.70. Chapter 6 also draws on survey data to show that about 80 per cent of all switchers take their gas and electricity from the same supplier. A feature of dual fuel supply noted in that chapter is that BGT has the largest share of dual fuel customers, despite having the most expensive dual fuel credit offering at all consumption levels in at least 12 out of 14 regions. This contrasts with customers' stated reasons for switching, which is price.

3.71. To examine this area further Frontier used survey data to analyse the relationship between the probability of switching arising as a direct result of having been contacted by a supplier. The framework used by Frontier to assess this aspect of switching behaviour relates to first time switchers over the 2003 period. This analysis confirms that switching to a dual fuel product was highly significant as a factor associated with the decision to change supplier as a result of direct contact with a supplier. This suggests that direct supplier contact played a substantial role in increasing switching rates in the Great Britain market in 2003 and, in particular, the rate of dual fuel take-up.

3.72. An element of the success of dual fuel is probably that customers perceive that it is convenient to be supplied by a single supplier and the potential for savings. The strength of fixed effects, evident in both the gas and electricity analysis discussed earlier in the chapter is likely to include the first of these factors.

Familiarity with brand and the fact that one of the fuels is already taken from the supplier may advantage these suppliers relative to others with equivalent offers at equivalent prices.

Summary

3.73. The measures of switching activity analysed in this chapter support the view that switching activity in the gas and electricity supply sectors remain at high levels. Around half of customers have now switched supplier.

3.74. At the individual customer level, the analysis of the reasons why customers do or do not switch highlighted the following:

- although customers say that price is the main reason for switching (see Chapter 2), a substantial amount of switching takes place to suppliers that may offer some savings but are not necessarily the cheapest offer
- the supplier brands most strongly associated with gaining such switchers are BGT and the ex-PESs
- it appears that suppliers that discount to BGT's gas price and the region's ex-PES electricity price can expect to attract switchers irrespective of their actual price, and
- although some demographic features (eg younger households or households with internet access) are associated with an increased likelihood of switching, features such as social group and tenure make no difference to the likelihood of switching.

3.75. It is possible that suppliers' fixed effects may mean that supplier activity (through doorstep selling, advertising, etc) has contributed to much of the switching activity, with customers switching in reaction to information from suppliers rather than maximising their savings by shopping around. This raises concerns as to whether the information currently available to customers about their consumption levels, current bill or the other choices available is inadequate to underpin their ability to maximise their savings.

3.76. The importance of relative prices may be indicative of inadequate incentives to constrain the prices of those suppliers with the strongest fixed effects. The

analysis in Chapter 4 about what appears to be a very weak link between electricity retail and wholesale prices tends to reinforce this view.

3.77. Given the importance of fixed effects and their potential to insulate BGT and the ex-PESs from competitive pressures, Ofgem is carrying out more analysis in this area. This will include consideration of the extent to which reductions in market share may have a role in influencing price levels, and supplier responsiveness to competition in the supply sector generally.