ofgem Making a positive difference for energy consumers

www.ofgem.gov.uk

11 April 2013

Factsheet 118

Understanding the profits of the large energy suppliers

To help make the energy market as open and clear as possible, Ofgem requires the six largest energy suppliers to publish annual financial statements showing the profits of the generation and supply parts of their businesses.

The six largest energy suppliers (Centrica, EDF Energy, EON, RWE Npower, Scottish Power and SSE) play a part in all areas of the energy supply chain. They each generate electricity and they also supply electricity and gas to homes and businesses (including industrial customers).

It can be difficult for consumers and other stakeholders to understand how profitable individual parts of the businesses are. This is because their financial reporting is usually done on a group basis.

In 2009 Ofgem introduced a new rule requiring the largest suppliers to produce statements showing the costs and profits for their generation and supply activities. This has improved the transparency of large suppliers' profits. We have now published our summary of the 2011 statements.

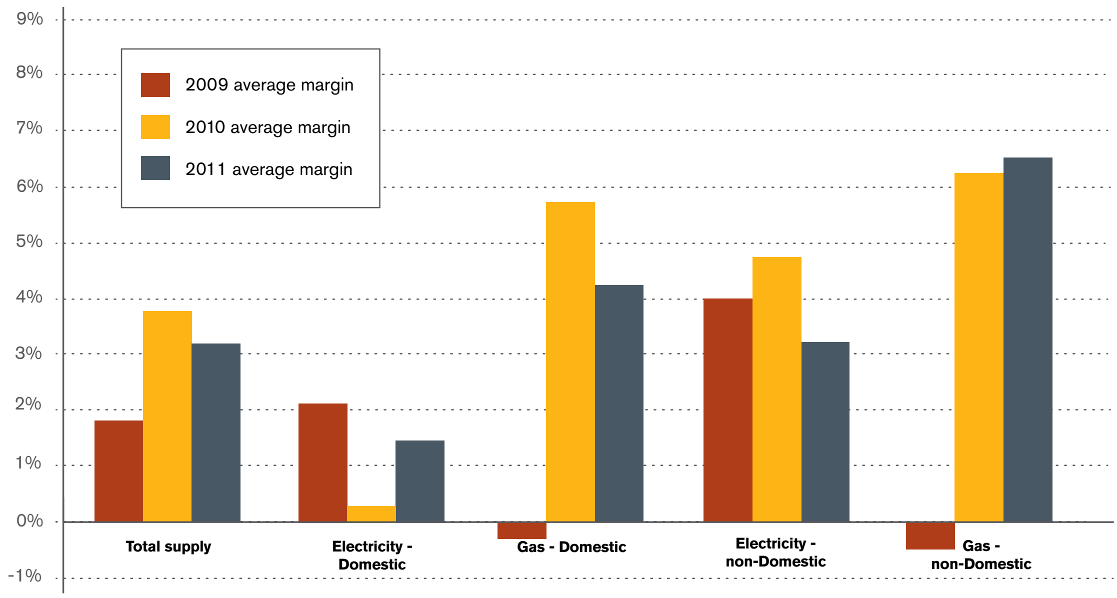
What do the 2011 accounts show?

The statements cover the year ending December 2011[1]. The information therefore does not cover the most recent profit announcements from the companies in 2013. Ofgem's review of the 2011 statements shows that:

- the average profit margin across all six suppliers for supplying gas and electricity to homes and businesses declined from 3.8 per cent in 2010 to 3.1 per cent in 2011
- the margins in generation, however, increased from 18.4 per cent in 2010 to 24.4 per cent in 2011. This is because of higher wholesale electricity prices. Typical generation margins also tend to be higher than in supply to finance the capital investment needed to build power stations

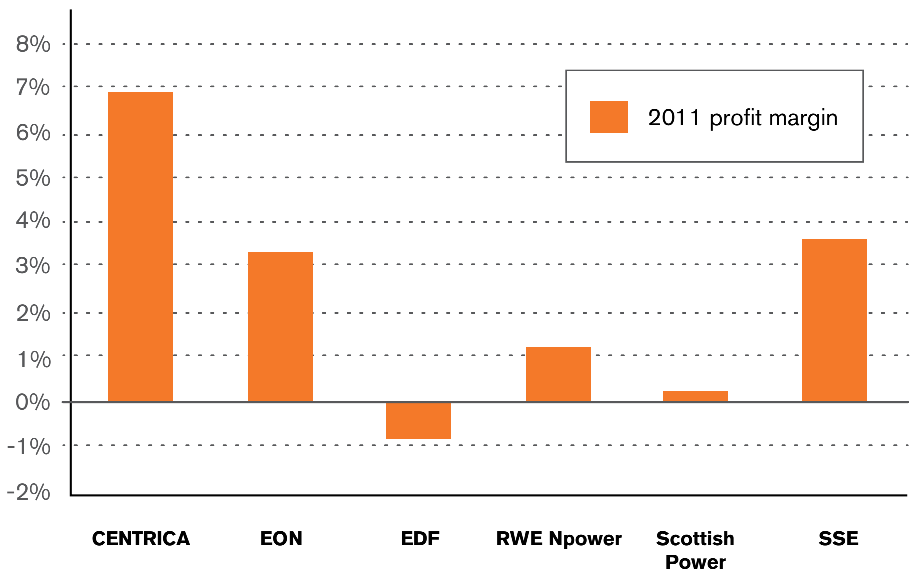
[1] The reporting year for five of the companies is to the end of December, but for SSE it is to the end of March.

Average profit margins



In the graph above we show average margins for all parts of suppliers' businesses (total supply) and then the margins for the individual parts of their supply businesses.

The graph below shows the total supply margins for each company in 2011 on supply of gas and power to homes and businesses. When these individual company margins are combined they result in the average margin shown for 2011 total supply in the graph above.



How much of a consumer's bill is profit?

The information in the statements allows us to look at how much the companies made from an average household in 2011. Out of an average household bill in 2011 of **£1,030** for both electricity and gas, the suppliers' net margin was **£33**. The difference between these figures is £997 which represents the total costs suppliers faced for buying and supplying energy and running their businesses.

Ofgem also publishes weekly supply market indicators which give the latest information on energy prices and profit margins here: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx These indicators suggest that margins and consumer bills have increased since 2011.

Is the amount of profit the large energy companies make fair?

Britain has a competitive energy market. This means Ofgem does not regulate the prices consumers pay, or the profits companies make. In a competitive market individual companies need to justify their profits and prices to their customers. Companies that compete less effectively will lose market share and therefore earn lower profits. Ofgem's remit, set by government, is to protect consumers' interests and one of its duties is to reduce barriers to effective competition.

So is competition working effectively?

Our 2011 Retail Market Review showed that competition was being stifled by poor supplier behaviour, confusing tariffs and a lack of transparency.

This is why we are planning the most radical changes to the market since competition began. We want a simpler, clearer and fairer energy market. To achieve this we propose to cut down the number of complex tariffs and simplify their structure. This will make it easier for consumers to find a cheaper deal. We also want to introduce other major changes to increase competitive pressure on suppliers. Our reforms are due to take effect from this summer. For more information see this press release: http://www.ofgem.gov.uk/Media/PressRel/Documents1/RMR%2021-02-13.pdf

Why do the profit margins vary between the companies?

In a competitive market you would expect variation between the profits and margins of the companies. Each of the large energy companies own different types of power stations, organise their business differently and have a different mix of customers.

These factors impact how the companies operate, including how much it costs to run their power stations and when they decide to generate power. This will have a corresponding impact on their profits.

Making sure the big six's statements are fit for purpose

Ofgem appointed an independent accountant, BDO, to closely examine the statements to see how well they were being completed and how easy they were to compare.

The accountant's main finding was that the methods the companies used to produce the statements were broadly fair and appropriate. It also made a number of recommendations to further improve transparency and comparability. As a result Ofgem changed the way in which the statements were to be completed. The 2011 submissions were made on this new basis.

Nonetheless, in a competitive market companies have the freedom to structure their businesses in a way that they deem fit to compete effectively against their rivals. This means that unless the companies are re-regulated and required to structure their businesses in a prescribed way, complete transparency is not possible. This form of re-regulation would also be incompatible with EU competition legislation.

Further improvements to statements

One of the recommendations made by BDO was to obtain an independent opinion of the quality of the 2011 statements. We commissioned the accountancy firm PKF to do this. Overall it concluded that the statements were still being completed appropriately by the companies. PKF also found that they were now easier to compare following the changes introduced by Ofgem.

However, PKF has highlighted a number of areas where improvements can still be made. They note that three of the companies (EDF Energy, Scottish Power and RWE Npower), presented supply and generation information without linking it to separately audited figures for supply and generation in their group accounts.

Over the coming months we will continue to look for ways to improve this year's submissions to help ensure the statements are clear, accurate and of use to consumers, market participants and other interested parties.

Further information

The 2011, 2010 and 2009 statements are all available on this link: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Reporting%202011%20Results%20Overview%20text.pdf

For public enquiries contact:

Consumer Affairs team
020 7901 7295 email: consumeraffairs@ofgem.gov.uk

For media enquiries contact:

Chris Lock, Senior Press Officer
020 7901 7225 email: chris.lock@ofgem.gov.uk