

Report

Outcome of 2021 review into whether conditions are in place for effective competition in domestic supply contracts

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This report sets out the outcome of our second review into whether conditions are in place for effective competition in domestic supply contracts. It includes our recommendation on whether the default tariff cap should be extended to the end of 2022. Our analysis follows the [assessment framework](#) that we published in October 2019, and provides an update on progress made since the [first annual review](#), published in August 2020.

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Executive Summary

This is a report on the outcome of our 2021 review into whether conditions are in place for effective competition in domestic supply contracts. We have updated our analysis to account for progress since our 2020 review and **our conclusion is that the conditions are still not yet in place. We therefore recommend that the price cap on default and standard variable tariffs (the “default tariff cap”) be extended to the end of 2022. This will protect approximately 15 million households**, including default prepayment meter customers. This report and the analysis underpinning it meets legislative requirements under Section 7 of the Domestic Gas and Electricity (Tariff Cap) Act 2018.

Our decision framework for undertaking this review sets out three conditions that, evaluating jointly, would need to be in place for there to be effective competition. Accounting for developments over the past year, our conclusions for each condition are:

- **Condition 1: structural changes from the government, Ofgem and the wider market are facilitating competition.**

Since our 2020 review, we have seen progress with the smart meter rollout, but the rate of installations has been impacted by the Covid-19 pandemic. From 1 January 2022, energy suppliers will have minimum annual installation targets under a new regulatory framework established by BEIS, which will continue to drive the progress of the rollout. Government is also consulting on additional measures to improve competition over the coming years, including creating a framework for the incremental introduction of an opt-in switching scheme.

We made a number of decisions over the past year which should help improve how the market functions and raise consumer confidence and trust, but these will need time to have an impact. For example, recent licence modifications, which have been in effect since January 2021, should improve supplier standards of financial resilience and customer service. Our Faster and More Reliable Switching Programme is expected to go live in summer 2022 subject to continued successful testing. Finally, we recently set out our expectation for industry to implement Market-wide Half-Hourly Settlement by October 2025, and we will put in place strong incentives and governance to ensure that implementation happens in a timely and effective manner. We are also working with government to consider additional initiatives to improve competition.

The market continues to provide platforms to help consumers engage, though these may differ in market coverage. Price comparison websites remain the most commonly known channel for consumers to compare and switch, while there is growing awareness

of scanning and auto switching services. However, more will need to be done to ensure digitally excluded customers can find good deals.

Overall, we conclude that Condition 1 is not yet met.

- **Condition 2: The competitive process should be expected to work well in the absence of the default tariff cap.**

Our annual Consumer Survey suggests that the trends in consumer engagement in previous years continued in 2020. Overall engagement levels remain driven by a pool of engaged consumers who have switched previously (“repeat switchers”), while households with vulnerable characteristics remain less likely than average to engage with the market. Switching rates slowed during 2020 and have fluctuated in 2021, increasing to high levels up to March/April but then decreasing significantly in May. The latter has coincided with the rise in wholesale prices that have reduced the potential savings from switching. With over half of all households currently protected by the default tariff cap, it is not clear if engagement levels across these consumers would be sufficient to constrain default tariff prices if the cap were removed.

Some of the positive trends in market structure have continued over the past year, with growth in previously medium-sized suppliers and a related fall in market share for the large legacy suppliers. Market concentration, as measured by the Herfindahl-Hirschman Index, was lower in Q1 2021 than in Q1 2020, but both electricity and gas markets are still considered to be concentrated under the Competition and Market Authority’s (CMA) market investigation guidance. Fewer suppliers entered the market compared to previous years and the risk of exit remains high, with exit rates in line with previous years and increased wholesale prices putting strain on supplier finances. It is also too early to say whether the Covid-19 pandemic will ultimately impact market structure.

Data on supplier profitability show that most large suppliers continued to make operational losses in 2020, but less so than in 2019. These suppliers are also pursuing efficiency programmes to lower their costs, which may bring them closer in line with the efficient benchmark of the default tariff cap, but these will take time to deliver lasting productivity gains. We continue to monitor this.

Overall, we conclude that Condition 2 is not yet met.

- **Condition 3: The competitive process should deliver fair outcomes for consumers.**

We continue to see the trends in price setting that we saw in last year’s review, with large suppliers setting their standard variable tariffs (SVTs) at the default tariff cap level – which represents a fair price for energy – while other suppliers consistently price below. Price differentials between SVTs and fixed tariffs have narrowed over the past year, as rising wholesale prices have fed through more quickly to fixed tariffs. Overall, there is currently no evidence to suggest that default tariff consumers would continue to be charged fair prices if the cap were removed.

There is no clear trend for how customer satisfaction is evolving, with quarterly satisfaction rates for large suppliers – and on average across all suppliers – tending to remain at or below levels when recording started in 2018, but falling to their lowest levels in Q1 2021. This has coincided with a significant increase in complaints volumes during the same quarter, broadly reverting to pre-pandemic levels.

Overall, we conclude that Condition 3 is not yet met.

1. Introduction

Context and related publications

- 1.1. The Domestic Gas and Electricity (Tariff Cap) Act 2018, hereafter the “Tariff Cap Act”,¹ required us to put a price cap on default and standard variable tariffs. This was due to widespread concern that the market was not working as well as it should for consumers on these tariffs, who are typically less engaged with the market and the products it offers. In particular, there was concern that these consumers were being overcharged for their energy supply.²
- 1.2. The default tariff cap is currently in place until the end of 2021. Section 7 of the Tariff Cap Act requires Ofgem to review whether conditions are in place for effective competition in the domestic retail market and make a recommendation on whether to extend the default tariff cap to the end of 2022. We must publish a report on the outcome of this review, including our recommendation, by 31 August 2021. The Secretary of State will consider it and make a decision by 31 October 2021. Under current legislation, if the default tariff cap is extended to the end of 2022 the same process will be repeated again in 2022 and the default tariff cap can be extended to the end of 2023 at the latest.³
- 1.3. The current report is the outcome of our 2021 review. It builds on last year’s review,⁴ focusing in particular on how the market has evolved over the past year and how we may expect it to evolve going forwards.

Overview of our decision framework

- 1.4. The review that we have undertaken follows the analytical decision framework that we developed, through consultation, in 2019.⁵ As illustrated in Figure 1 below, the

¹ See [Domestic Gas and Electricity \(Tariff Cap\) Act 2018](#).

² For example, see para 160 of CMA (2016), “[Energy market investigation: Final report](#)”.

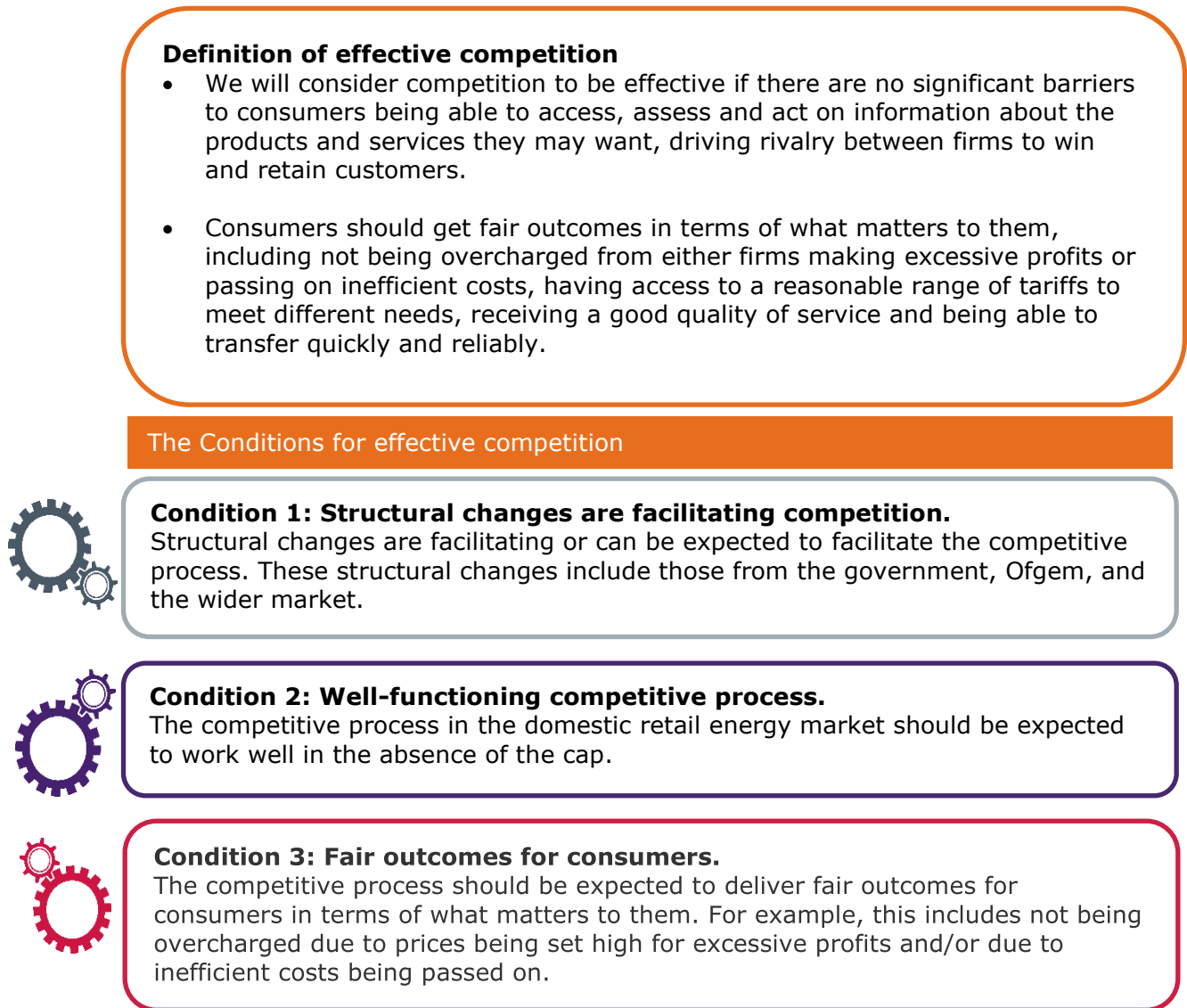
³ On 23 July 2021, BEIS published its [retail strategy](#). This includes an announcement that, subject to Parliamentary time and approval, it intends to allow for future extensions of the default tariff cap beyond 2023 (if needed).

⁴ See Ofgem (2020) “[Outcome of review into whether conditions are in place for effective competition in domestic supply contracts](#)”.

⁵ See Ofgem (2019) “[Decision – Framework for assessing whether conditions are in place for effective competition in domestic supply contracts](#)”.

framework consists of a definition of effective competition⁶ and three conditions for effective competition. While the conditions may be satisfied individually to differing degrees, we will assess whether they have been met collectively.⁷

Figure 1: Overview of the conditions for effective competition



⁶ The Tariff Cap Act does not define effective competition, nor is there a generally accepted definition in relevant policy frameworks or academic literature. For our decision framework, we therefore developed a definition. Our definition and related conditions should be viewed within the context of the requirements under the Tariff Cap Act.

⁷ See pages 16 and 19 of Ofgem (2019) "[Decision – Framework for assessing whether conditions are in place for effective competition in domestic supply contracts](#)".

Covid-19 and its implications for this review

- 1.5. As discussed in last year’s review, the Covid-19 pandemic and resulting social distancing measures have impacted the economy and in turn the retail energy market. Since the pandemic began, we have been closely monitoring the impacts this may have on households; through energy affordability challenges caused by lower income and consuming more energy at home; and through impacts on engagement. We have also monitored the financial position of suppliers and market structure.
- 1.6. While some of the immediate impacts of the pandemic on progress towards effective competition have been clear, such as impacting smart meter installations, the overall scale and time-horizon of any other impacts on competition remain uncertain. Overall, while Covid-19 has not helped progress in meeting the three conditions we set out, it has neither changed nor driven the outcome of this assessment.

Our recommendation

- 1.7. Our conclusion is that the conditions for effective competition are not yet in place and we recommend extending the default tariff cap to the end of 2022. Our analysis supporting this is set out in the remainder of this report:
- in Chapter 2, we assess progress in implementing structural changes to facilitate competition (Condition 1 from our decision framework).
 - in Chapter 3, we assess how the competitive process may be expected to work in absence of the default tariff cap (Condition 2 from our decision framework).
 - in Chapter 4, we assess whether competition can be expected to deliver fair outcomes for consumers (Condition 3 from our decision framework).

Your feedback

- 1.8. We believe that feedback is an important part of good analysis. We are keen to receive your comments about this report, including any answers to:
1. Have we accurately described market developments?
 2. Are the conclusions that we reach balanced?
 3. Do you have any comments about its tone and content?

4. Was it easy to read and understand?
5. Any further comments?

Please send any general feedback comments to EffectiveCompetition@ofgem.gov.uk.

2. Assessing condition 1: Structural changes should facilitate competition

Chapter summary

In this chapter, we set out our view that **Condition 1 is not yet met**. We find that:

- progress in installing smart meters has been impacted over the past year by the Covid-19 pandemic. A new regulatory framework with annual installation targets will be in place from 1 January 2022 to drive further progress. Government is also consulting on additional measures to improve competition over the coming years, including creating a framework for the incremental introduction of an opt-in switching scheme.
- Ofgem has made a number of decisions over the past year that should help improve how the market functions in the coming years, but these will need time to have an impact – for example through gradually increasing consumer confidence and trust in the market and incentivising innovation.
- These changes include licence modifications, which came into effect in January 2021, to raise supplier financial resilience and improve customer service; as well as setting out our expectation for industry to implement Market-wide Half Hourly Settlement by October 2025. The Faster and More Reliable Switching Programme is expected to go live in summer 2022 subject to continued successful testing.

- 2.1. Our first condition is that structural changes from the government, Ofgem, and the wider market should facilitate competition. Each of the structural changes that we consider has a bearing on how well competition works, for example through allowing consumers to better understand their energy use and make informed choices, being able to act on these choices by switching swiftly and reliably, as well as ensuring suppliers are financially prepared to meet their commitments.

Structural changes from government

The smart meter rollout has been impacted by the Covid-19 pandemic over the past year

- 2.2. Smart meters should facilitate the competitive process through giving consumers both real time and historic data on their energy use, allowing them to make more informed choices and removing barriers to engagement. Consumers benefit most

when meters operate in smart mode, providing them with accurate price information and access to a wider range of tariffs.

- 2.3. Progress has been impacted by Covid-19 and resulting social distancing measures over the past year. Installations picked up after Q2 2020, but remained lower year-on-year by 20% (Q3 2020), 16% (Q4 2020) and 23% (Q1 2021). Over one third of domestic meters are currently operating in smart mode.^{8,9}
- 2.4. The obligation on suppliers to take "all reasonable steps" has been extended until 31 December 2021, due to the uncertainty around Covid-19 and to provide time for suppliers to increase installation rates closer to normal levels. From 1 January 2022, a four-year framework with annual installation targets for suppliers will be in place.¹⁰
- 2.5. The BEIS 2020 Energy white paper¹¹ announced plans to introduce a number of measures to improve competition and address factors causing excessive charging. This includes creating a framework for the incremental introduction of an opt-in switching scheme, as well as testing opt-out switching. In July 2021, BEIS published a consultation on these switching schemes.¹²

Structural changes from Ofgem

Market-wide Half Hourly Settlement should, in time, improve retail market competitiveness

- 2.6. As smart meters can record energy consumption every half-hour, they are capable of enabling half-hourly settlement. Market-wide Half Hourly Settlement (MHHS) means suppliers will face the true costs of serving their customers, incentivising the development of new products (including tariffs) and services which reward customers for shifting their consumption to times when electricity is cheaper to generate and transport; so improving the efficiency of domestic electricity supply.

⁸ See [BEIS \(2021\) "Smart meters Statistics"](#)

⁹ Progress has also been made on migrating first generation smart meters (SMETS1), to ensure meters retain smart functionality when consumers switch: total migrations have increased from 660,000 in Jul 2020, to 4.5m as of Jul 2021. See [Data and Communications Company \(DCC\)](#).

¹⁰ See BEIS (2020) "[Delivering a smart system: Response to a Consultation on a Smart Meter Policy Framework post 2020](#)".

¹¹ See BEIS (2020) "[Energy white paper: Powering our net zero future](#)"

¹² See BEIS (2021) "[Energy retail: opt-in and testing opt-out switching](#)"

- 2.7. In addition, better quality and more frequent settlement data, combined with greater administrative efficiency, should encourage non-traditional players with disruptive business models to enter the market and compete with existing suppliers. This new entry, together with the exposure to the true costs of serving customers, should also stimulate an innovative response from those already in the market. A faster settlement timetable means suppliers would need less collateral to cover their potential settlement liabilities, which should reduce barriers to new entry.¹³ This, combined with improvements in efficiency, will improve the competitiveness of domestic electricity supply.¹⁴
- 2.8. In April 2021, we set out our expectation for industry to implement MHHS by October 2025.¹⁵ We will put in place strong incentives and governance to ensure that implementation happens in a timely and effective manner. We estimate that our chosen option for MHHS will deliver net benefits to GB energy consumers in the range of £1,559m-£4,509m over the period 2021-2045.¹⁶

Our Faster and More Reliable Switching Programme measures should improve consumers' experience of switching and increase engagement

- 2.9. Accurate and timely switching should facilitate market engagement by allowing consumers to switch with confidence, quickly and without disruption. Our work on the Faster and More Reliable Switching Programme has continued and, subject to continued successful testing, the programme is forecasted to go live in summer 2022.

Recent license changes should improve customer service and increase consumer confidence

¹³ When a supplier fails, certain costs can be mutualised across other suppliers. While this helps to ensure that the failed supplier's customer credit balances are protected, and that the integrity of government schemes is maintained, we want to reduce the wider impact that supplier failure has on other suppliers and consumers. Part of this means taking action to ensure the cost mutualisation arrangements do not encourage inefficient entry or expansion of poorly-prepared suppliers. As part of our Supplier Licensing Review, we have taken steps to improve supplier standards of financial resilience without presenting any undue barriers to entry, innovation or expansion. A reduction in settlement collateral requirements would further reduce any such remaining barriers that existed

¹⁴ We consider that our work on Market-wide Half-Hourly Settlement effectively remedies the adverse effect on competition identified in para. 187 of CMA (2016), "[Energy market investigation: Final report](#)" (see Ofgem's "[Market-wide Half-Hourly Settlement: Final Impact Assessment](#)").

¹⁵ See Ofgem (2021) "[Electricity Retail Market-wide Half-Hourly Settlement: Decision Document](#)".

¹⁶ See Ofgem (2021) "[Market-wide Half-Hourly Settlement: Final Impact Assessment](#)".

2.10. The changes made in our Supplier Licensing Review should act to increase consumer confidence and trust in the market by promoting more financially responsible business models from suppliers, and reducing the mutualisation costs associated with supplier failure.

2.11. Licence modifications in effect since January 2021 introduce a package of measures to drive up standards among energy suppliers and minimise industry and consumer exposure to financial risks and poor customer service. Through promoting more responsible risk management and improved governance and accountability, these changes will help minimise the likelihood and impact of disorderly supplier exit.¹⁷

Structural changes from the wider market

Price comparison websites are facilitating engagement but solutions may need to emerge to help digitally-excluded customers find good deals

2.12. Platforms such as price comparison websites (PCWs), scanning services and automatic switching services may help consumers engage with the market through a range of different channels. PCWs remain the most commonly known channel for consumers to compare and switch.¹⁸ This is positive for engagement overall, but more may need to be done to protect digitally-excluded consumers who cannot access cheaper online only tariffs.¹⁹ PCWs may also differ in their market coverage.²⁰ There is growing awareness of scanning and auto switching services, but sign-up to these services is low in comparison.²¹

Overall conclusion: Condition 1 is not yet met.

¹⁷ See Ofgem (2020) "[Supplier Licensing Review: Ongoing requirements and exit arrangements](#)".

¹⁸ See Ofgem (2021) "[Consumer Perceptions of the Energy Market](#)".

¹⁹ The vast majority of tariffs are only available online/paperless and an increasing number are exclusively available to new customers. The exact price differential levels for those customers who are digitally excluded may vary over time.

²⁰ See Citizens Advice "[The real deal: how do price comparison websites measure up?](#)"

²¹ [Ofgem 2020 Consumer Survey](#)

3. Assessing condition 2: well-functioning competitive process

Chapter summary

In this chapter, we set out our view that **Condition 2 is not yet met**. We find that:

- switching rates slowed during 2020 and have fluctuated in 2021, increasing to high levels up to March/April but then decreasing significantly in May.
- overall consumer engagement levels continue to be driven by a pool of engaged consumers who have switched previously (“repeat switchers”). Those on lower incomes or with vulnerable characteristics remain less likely to engage with the market.
- over half of all households are still on default tariffs and are therefore currently protected by the default tariff cap. It is not clear that engagement across this group of consumers would be sufficient to constrain default tariff prices if the cap were removed.
- market concentration has fallen over the past year as large legacy suppliers lost market share, but both gas and electricity markets remain concentrated.

- 3.1. When the competitive process is working well, consumers are able to access, assess and act on information available to them. When sufficient numbers of consumers actively participate in the market, this incentivises market providers to become more efficient, to improve their technology and to bring innovative business models and products to the market. This creates a virtuous circle, where consumer engagement drives rivalry across market providers.
- 3.2. As set out in our decision framework, there are three parts to our assessment of the competitive process: we assess (1) the evolution of consumer engagement and any barriers to engagement, (2) market structure and competitive dynamics and (3) supplier performance including commercial opportunity.²²

[Ofgem \(2020\) "Ofgem Consumer Survey 2020"](#)

²² See Ofgem (2019, p.30) ["Decision – Framework for assessing whether conditions are in place for effective competition in domestic supply contracts"](#).

Consumer behaviour

3.3. A consumer engages with the energy market when they take steps to identify the best deals for them, and act on this information through deciding whether or not to switch tariff/supplier.²³ There are a range of different ways that consumers may engage, such as through direct search, price comparison websites or by proxy through automatic switching services. Consumer engagement, in its various forms, is central to driving competition between market providers to win and retain consumers. The higher the level of consumer engagement, the more responsive consumers are to the prices suppliers charge and the quality of service they provide. This places a restraint on price-setting behaviour and incentivises good customer service.

Consumer engagement continues to be driven by repeat, rather than first time, switchers

3.4. Overall consumer engagement has been increasing in recent years, with much of this increase driven by growth in repeat switchers: ie, those who switched in the past 12 months and have switched previously. However, many groups of consumers do not engage and we consistently see that those with circumstances and characteristics that make them vulnerable, such as being in financial difficulty, are less likely to engage with the market. The results from our latest annual Consumer Survey suggest that many of these trends have continued in 2020 and we discuss some of these in detail below. The 2020 figures are not directly comparable with previous years because the survey method changed from face-to-face to online interviews, with a smaller telephone survey in parallel. We present results from the telephone sample as these are more comparable with previous face-to-face results.²⁴

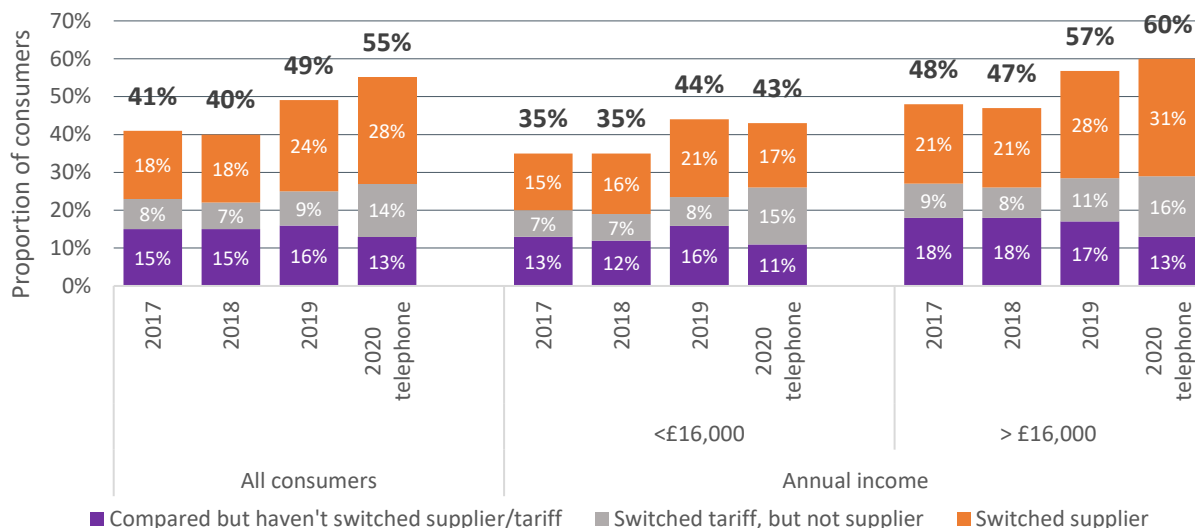
3.5. As illustrated in Figure 2, it remains the case that a large fraction of engaged consumers choose to switch suppliers. However, the 2020 results suggest that, as in previous years, engagement continues to be lower for those with lower incomes. Even though this group has search and switching tariff levels that are comparable

²³ See Ofgem (2019, p.12) "[Insights from Ofgem Consumer Engagement Trials: what works in increasing engagement in energy tariff choices](#)" for further details

²⁴ The 2020 survey was conducted online. Consumers who answer online surveys tend to be more engaged with the market and inclined to switch energy deals. They also show greater confidence in their ability to select an energy deal. For these reasons, the 2020 results are not directly comparable with previous years.

with those on higher incomes, their engagement levels are ultimately lower because they are less likely to switch supplier (see Figure 2).

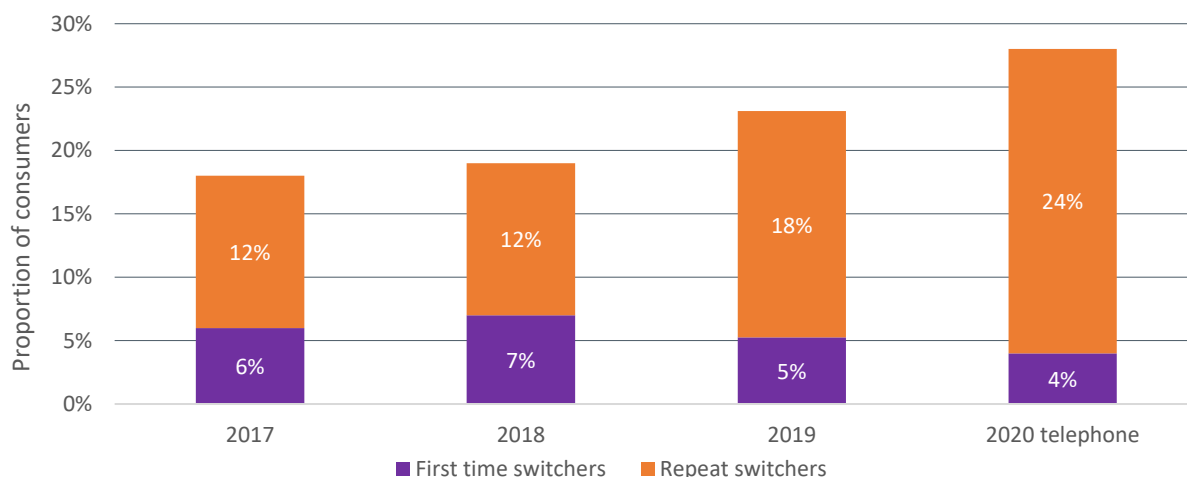
Figure 2: Consumer engagement, overall and by income, 2017-2020 ²⁵



Source: Ofgem Consumer Surveys 2017 - 2020.

3.6. Figure 3 shows that switching continues to be mostly driven by repeat switchers, which may suggest that this group continues to see the benefits of engaging with the market. The proportion of consumers switching supplier for the first time has remained relatively flat in recent years.

Figure 3: Supplier switching - first time and repeat switchers, 2017-2020



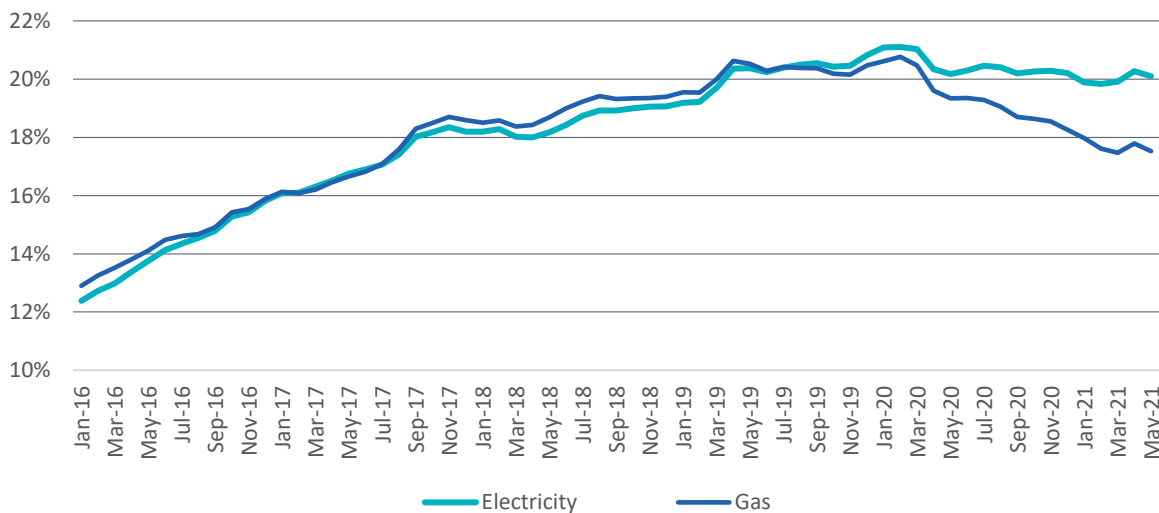
Source: Ofgem Consumer Surveys 2017 - 2020.

²⁵ The income threshold for the 2020 telephone survey is >£15,500.

Switching rates slowed during 2020 and have fluctuated in 2021

3.7. Prior to the pandemic, consumer switching had been on the rise, and reached record levels in February 2020. The rolling average annual switching rate for electricity increased from 13% in February 2016 to 21% in February 2020 (see Figure 4). In last year’s review, we noted the first signs of a slowing in switching rates during the pandemic. This trend continued with total switches for the 12 months up to February 2021 5% and 15% lower for electricity and gas respectively, compared to the 12 months up to February 2020. Switching has so far fluctuated in 2021, with the number of switches increasing up to high levels in March/April, but then decreasing significantly in May. The rolling average switching rate for electricity currently sits at 20% (as of May 2021) and we will continue to monitor how this evolves. The drivers of switching rates are complex, and the slowing may only be partially linked to factors such as the pandemic and the recent narrowing of price differentials due to rising wholesale prices.

Figure 4: Rolling average annual switching rate



Note: The switching rates at each date are calculated as the ratio between the total number of switches during the previous twelve months and the average number of meter points during the same period.

Source: Ofgem analysis of data from electricity distribution network operators (DNOs) and Xoserve.

Over half of households remain on default tariffs

3.8. In line with the lack of growth in first time switching and overall slowing of switching rates in 2020, we find that there has been no significant reduction in the proportion of consumers on default tariffs over the past year. As of April 2021, 51% of

consumers were on default tariffs for electricity,²⁶ with over two-fifths this group having been on a default tariff for over three years.²⁷

The reliability of the switching process is a concern for some consumers

3.9. In a well-functioning competitive process, consumers should be able to switch supplier swiftly and reliably, and have the confidence that this will happen. Across 2017-19, our Consumer Survey results suggest that around 11% of consumers have concerns about something going wrong in the switching process, while 14% of consumers have held concerns about being doubled billed.²⁸ A smaller proportion of consumers also have concerns that the supplier they switch to may go bust, but these concerns have been increasing over time.²⁹ Our Faster and More Reliable Switching Programme should help address concerns over something going wrong, while our ongoing Supplier Licensing Review changes should help improve consumer confidence and trust that suppliers they switch to are financially responsible.

3.10. Average switching times for electricity and gas have been relatively stable since our last review and across recent years, at 16 and 18 days, respectively.³⁰ The proportion of erroneous electricity transfers, where consumers remain with or are switched to suppliers against their wishes, has stayed broadly stable since 2014, fluctuating between 0.5-0.9%.³¹ During this period, the wrong meter point being switched has accounted for nearly 65% of erroneous electricity transfers. These errors are caused by issues such as inaccurate customer address data held across

²⁶ This figure covers all suppliers and is estimated using the number of electricity customer accounts.

²⁷ As in our 2020 review, this figure does not include Bulb. This is because Bulb offers only one variable tariff which, while being an SVT, is priced competitively with fixed tariffs and is used to acquire customers.

For consistency with our 2020 review, the figure also does not include prepayment customers on default tariffs, who are now protected under the default tariff cap. This follows the expiration of the CMA prepayment price cap, which we ran from 2017 to the end of 2020. Since 1 Oct 2020, the default tariff cap has included a new level for the PPM method, and PPM consumers will be protected in this way for as long as the cap remains in place. If we include default PPM customers, then percentage of customers on default tariffs for electricity increases to 58%.

²⁸ Data based on 2017-2019 Consumer Survey results. While the magnitudes of our 2020 survey results are not directly comparable, the relative ordering of perceived risks to switching for consumers remain similar. Concerns about being double billed remain higher than being cut off.

²⁹ Data based on 2017-2019 Consumer Survey results.

³⁰ Ofgem analysis of electricity distribution network operator (DNO) and Xoserve (gas) data. Data from September 2020. Information correct as of January 2021.

³¹ Data is up to and including January 2021.

the industry.³² Inaccurate data also slows down the speed of the switching process. Both the accuracy of data and switching times will be markedly improved with our Faster and More Reliable Switching Programme.

Market structure and dynamics

3.11. In line with our online data portal,³³ we categorise suppliers into the following groups (unless otherwise stated): 'Large legacy' includes suppliers which have held a market share of at least 5% in either fuel since privatisation of electricity and gas sectors.³⁴ 'Large other' includes suppliers with market share of at least 5% in either fuel, having increased market share from below 5% at the time of privatisation. 'Medium' includes suppliers with market share exceeding 1%, but remaining below 5% in both fuels. Finally, 'Small' includes suppliers with market share below 1% in both fuels.³⁵

Market concentration has fallen as large legacy suppliers continue to lose market share

3.12. Falling market concentration may improve consumer outcomes because larger suppliers have less market power when setting prices and the quality of service they provide. Concentration in both domestic electricity and gas retail energy markets has fallen significantly since the CMA Energy Market Investigation in 2014-16 and has fallen over the past year, with concentration lower in Q1 2021 than in Q1 2020 (see Figure 5).³⁶ While the acquisitions of SSE by OVO and npower by E.ON increased

³² See [Utility Week \(2021\) "Optimising address data to drive efficiency"](#)

³³ See Ofgem (2021) "[Retail market indicators](#)".

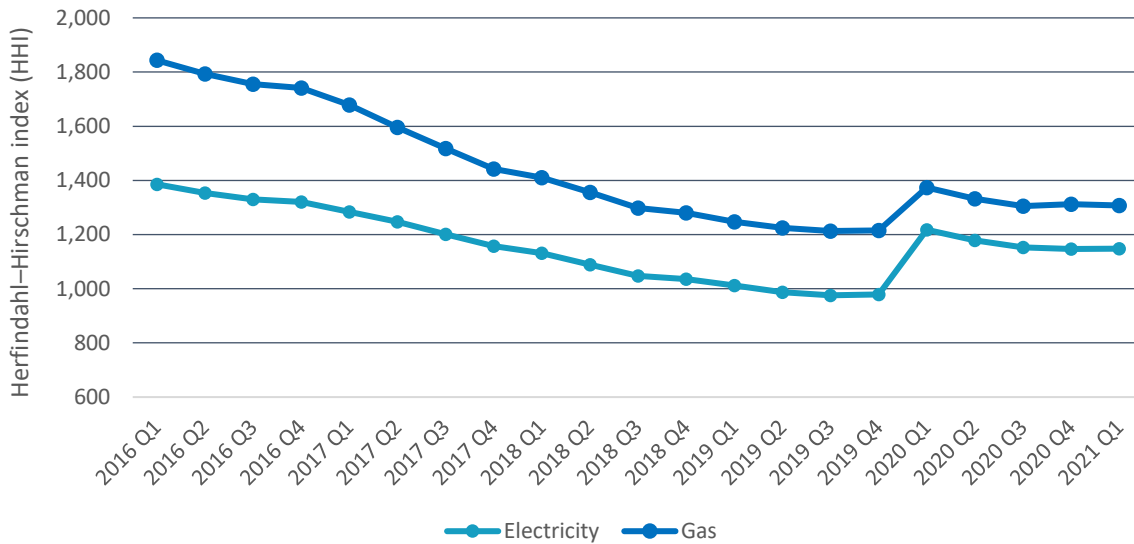
³⁴ This is British Gas, SSE, E.ON, EDF, Scottish Power and npower up to January 2020, but thereafter British Gas, OVO, E.ON, EDF and Scottish Power. This follows the acquisitions of SSE by OVO in January 2020 and npower by E.ON in September 2019 (customers began being transferred to E.ON in January 2020). OVO is classified as a large legacy supplier because the majority of its customers come from the acquisition of SSE.

³⁵ The assessment presents data across the period 2016-2021, unless otherwise stated, and draws on the most contemporary data available at the time of the analysis.

³⁶ The Herfindahl-Hirschman Index (HHI) measures market concentration by summing the squares of the market share of each firm. It provides insights into how competitive a market is. The closer a market is to being a monopoly, the higher will be the measure of concentration. The CMA typically regards markets with HHI below 1,000 as unconcentrated, markets with HHI between 1000 and 2000 as concentrated, and markets with HHI above 2,000 as highly concentrated. See CMA's [latest market investigation guidelines](#). The HHI for the electricity market was 1,148 in Q 2021. The gas retail market remains more concentrated than electricity, with a HHI value of 1,308 in Q1 2021.

market concentration between 2019 Q4 and 2020 Q1, it then fell over the subsequent two quarters and has since stabilised.

Figure 5: Market concentration – Herfindahl-Hirschman Index (HHI)

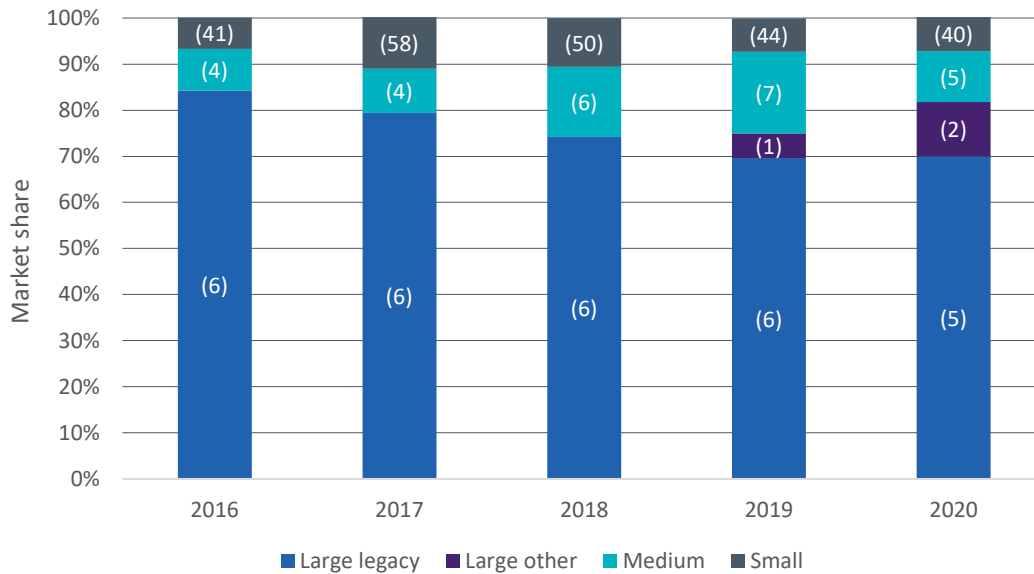


Source: Ofgem’s analysis of Distribution Network Operators data.

3.13. The reduction in market concentration reflects the falling market shares of large legacy (incumbent) suppliers, as well as growth and consolidation of previously mid-tier suppliers. Between Q1 2020 (the data used in our last review) and Q4 2020, the collective market share of large legacy suppliers fell from 73% to 70%.³⁷ Between 2019 and 2020, there has been growth in the number of ‘large other’ suppliers. These suppliers (Octopus and Bulb) now have an electricity market share of greater than 5% each. Collectively, they held around 12% of the electricity market in Q4 2020. Between 2019 and 2020 the number of large legacy suppliers fell from 6 to 5 because of E.ON’s acquisition of npower (see Figure 6); the number of large other suppliers increased from 1 to 2 because Octopus’s market share increased to more than 5%; finally the number of medium suppliers fell because of OVO’s acquisition of SSE and the reclassification of Octopus Energy as ‘large other’.

³⁷ To put these numbers in context, the collective market share of large legacy suppliers as classified in Q4 2016 was 84%.

Figure 6: Electricity market shares by supplier size (and number of suppliers), 2016 - 2020³⁸



Source: Ofgem’s analysis of Distribution Network Operators and Xoserve data.

Notes: The threshold for “large legacy” is a market share of at least 5% since sector privatisation. The threshold for ‘large other’ is a market share of at least 5%, having increased from below 5% at the time of privatisation. “Medium” suppliers have market share of at least 1% but less than 5%, while small suppliers have market share less than 1%.

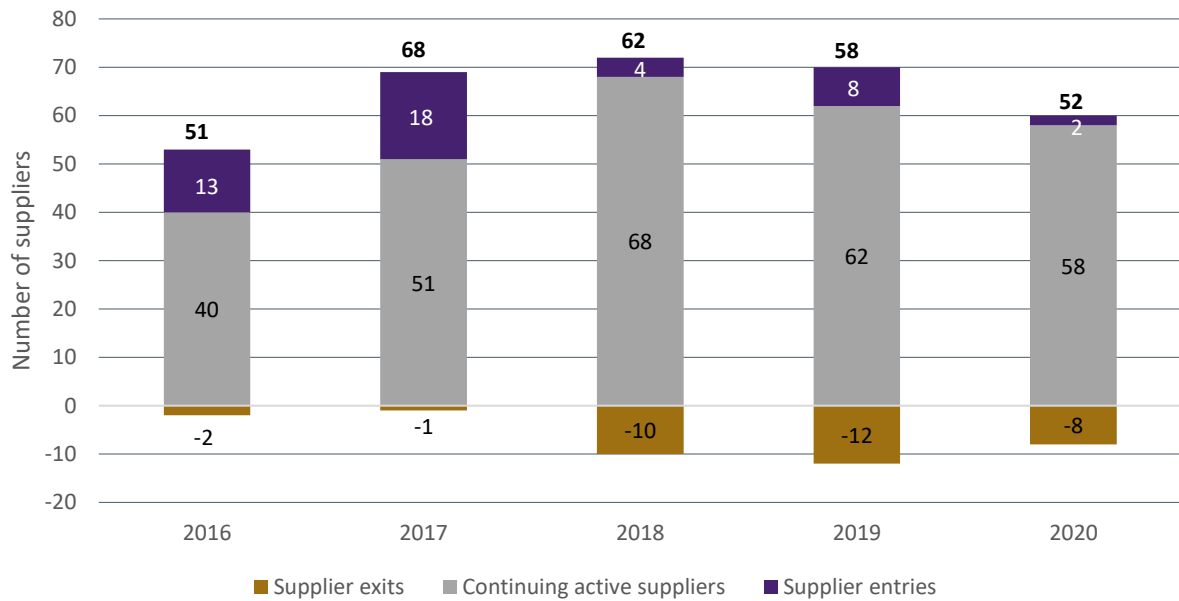
As in the previous two years, more suppliers exited the market than entered in 2020

3.14. Between March 2020 and March 2021, the number of active suppliers in the domestic retail market fell from 57 to 49.³⁹ This was due to only two new suppliers entering and ten suppliers leaving the market. This reduced entry level, possibly affected by the Covid-19 pandemic, is in stark contrast with eight market entries between March 2019 and March 2020. On the other hand, the number of exits was similar to that observed previously, both in number and type, with just below half of the cases due to suppliers’ failures, followed by a Supplier of Last Resort (SoLR) appointment, and the remaining cases due to trade sales. See Figure 7 for annual entry and exits since 2016.

³⁸ Data is based on Q4 of each year.

³⁹ Ofgem retail portal.

Figure 7: Entry and exit of suppliers, 2016-2020



Source: Ofgem’s analysis of Distribution Network Operators and Xoserve data.

Notes: “Continuing active suppliers” refers to the number of suppliers at the beginning of each year. The figures above each bar refer to the number of suppliers at the end of each year, having accounted for supplier entries and exits.

3.15. Market exit is part of the normal competitive process and a retail market that exhibits effective competition would be expected to have some degree of supplier exit. However, exits sometimes occur because suppliers are insufficiently prepared for growth and adopt unsustainable pricing practices or business models. These can harm consumers and ultimately undermine their confidence and trust in switching and the market as a whole, as well as distort competition through costs to be mutualised. Suppliers should therefore be able to demonstrate that they are well prepared to meet their obligations and maintain good quality of service as they grow. The changes that we are making through our Supplier Licensing Review should help to facilitate this.⁴⁰

Supplier performance

⁴⁰ See Ofgem (2020) [“Decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements”](#).

3.16. In a well-functioning competitive retail market, we would expect that over time competitive pressures would promote efficiency⁴¹ and limit the scope for excess profits. While the primary aim of the default tariff cap is to protect consumers on default tariffs from being overcharged,⁴² it also provides an incentive for suppliers to improve their efficiency through the allowance we set for operating costs.⁴³

Suppliers are pursuing measures to improve efficiency, but these will take time to bear fruit

3.17. Large and medium sized suppliers are undertaking a range of measures to improve their efficiency. These include organisational restructures, moves to digital platforms and wider investments in technology to reduce operating costs. However, we recognise that these will take time to have effect.⁴⁴

3.18. Figure 8 uses data on the profitability of the large suppliers⁴⁵ to show how indirect operating costs per customer account have evolved for the large suppliers over 2014 to 2020. This metric can be viewed as a proxy for efficiency because indirect costs capture those costs that suppliers have most control over.⁴⁶ They include sales and marketing costs, bad debt costs, costs to serve, IT costs, staffing costs, billing and all meter costs.⁴⁷

3.19. While indirect operating costs per customer account⁴⁸ have, on average, tended to rise over this period, we have seen signs of a reduction in real terms over the past two years. However, this is the result of significantly different trends across individual suppliers. This suggests that it may take time for suppliers to descale their indirect costs as customer numbers fall. We will continue to monitor how this

⁴¹ This metric does not control for all factors that may be relevant to efficiency: for example, it does not control for differences in cost-to-serve. All else constant, a supplier with lower cost-to-serve customers (eg, a higher proportion of customers who pay by direct debit or use online services) will appear more efficient by this metric.

⁴² See Ofgem (2018, p.11) "[Decision - Default tariff cap - Overview document](#)".

⁴³ Section 1(4) of the Tariff Cap Act states that, in setting the cap, we must have regard for "the need to create incentives for holders of supply licences to improve their efficiency".

⁴⁴ Cornwall Insight (2020) "Domestic Supplier Insight Service Q4 2020".

⁴⁵ Data from Consolidated Segmental Statements

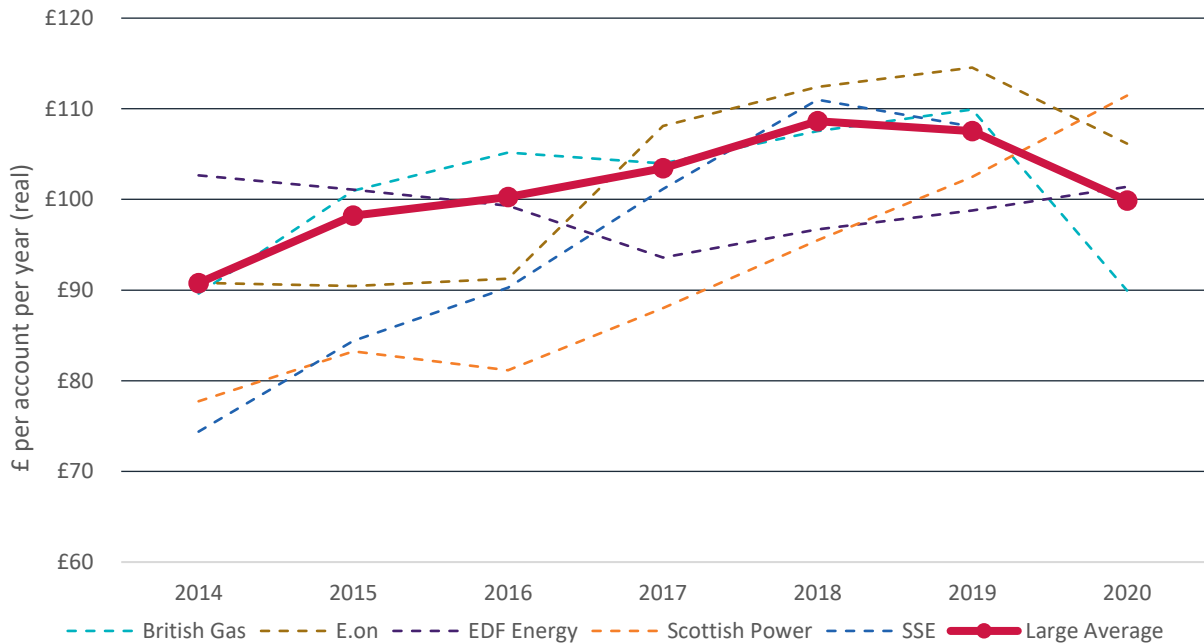
⁴⁶ Variation in operating costs can be a key source of relative efficiency/inefficiency across suppliers, as discussed for example in Ofgem (2018) Default Tariff Cap Decision: Appendix 6.

⁴⁷ Indirect costs are defined in our existing CSS guidelines: see Ofgem (2015, p.5) "[CSS Guidelines](#)".

⁴⁸ This metric does not control for all factors that may be relevant to efficiency: for example, it does not control for differences in cost-to-serve. All else constant, a supplier with lower cost-to-serve customers (eg, a higher proportion of customers who pay by direct debit or use online services) will appear more efficient by this metric.

evolves. While we cannot currently make like-for-like comparisons with medium and smaller suppliers, we expect to be able to analyse this in more detail in any subsequent assessments.

Figure 8: Indirect operating costs per customer account 2014-2020 (2020 prices)

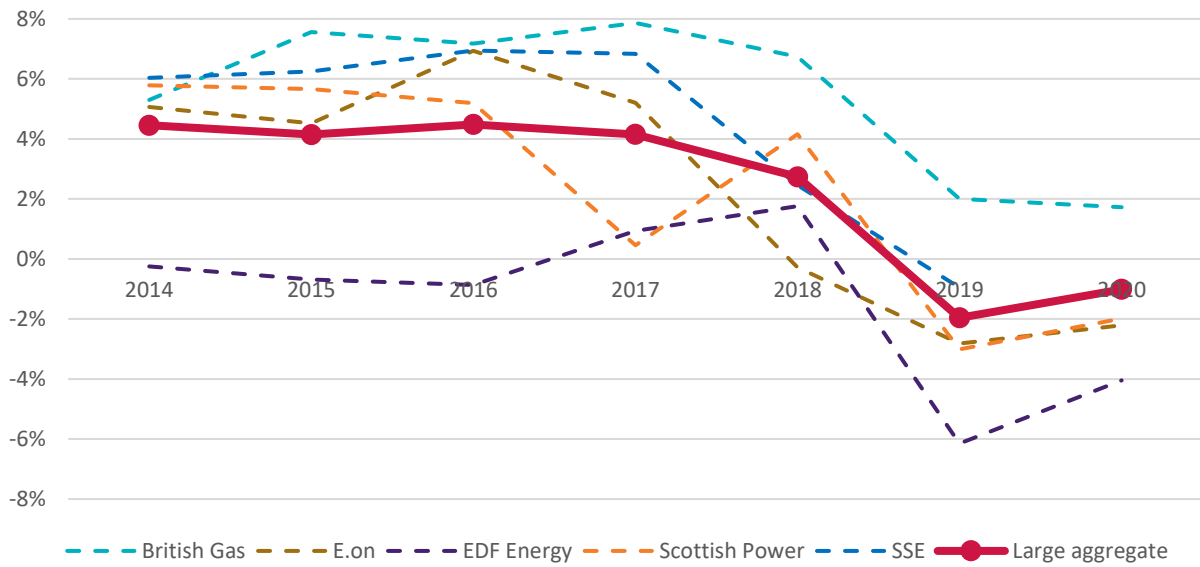


Source: Ofgem’s analysis of data compiled from consolidated segmental statements (CSS).
 Notes: The average for 2020 does not include OVO/SSE.

Profits for the large suppliers have fallen in recent years and become negative: this may be due to factors including competition, efficiency and pricing strategies.

3.20. Our assessment also considers the underlying profitability of suppliers. Figure 9 presents the earnings before interest and tax (EBIT) margins for the large suppliers between 2014 and 2020, as well as on aggregate across this group. As reported in last year’s review, aggregate EBIT margins fell annually between 2016-2019 and became negative in 2019. The aggregate EBIT margin remained negative in 2020 but less so than in 2019. The lower margins in recent years may be attributed in part to increased competition, while we have also seen profitability fall since the introduction of the default tariff cap in 2019. Under the default tariff cap suppliers are incentivised to become more efficient and can no longer recover any losses or low margins on fixed tariffs through default tariff consumers. However, a supplier’s overall profitability is affected by their overall efficiency and pricing decisions across the range of products they offer, including fixed tariffs that are outside the scope of the default tariff cap.

Figure 9: Aggregate EBIT margins of large suppliers 2014-2020



Source: Ofgem’s analysis of data compiled from consolidated segmental statements (CSS).
Notes: The average for 2020 does not include OVO/SSE.

Overall conclusion: Condition 2 is not yet met.

4. Assessing condition 3: fair outcomes for consumers

Chapter summary

In this chapter, we set out our view that **Condition 3 is not yet met**. We find that:

- large suppliers continue to set their default tariff prices within a few pounds of the default tariff cap while others are able to price below.
- price differentials between default and fixed tariffs have narrowed in recent months as rising wholesale prices are passed through more quickly to fixed tariffs.
- there is no clear trend in how overall customer satisfaction is evolving. Quarterly rates of satisfaction have tended to remain at or below levels seen since recording started in 2018, but fell to their lowest levels in Q1 2021.

4.1. The competitive process will generate a range of different outcomes for consumers, in terms of the price that they pay for the energy and the service that they receive. As we set out in our decision framework, the competitive process should deliver fair outcomes for consumers, including that:⁴⁹

- consumers should not be overcharged for their energy use, for example through firms making excessive profits or passing on inefficient costs.
- consumers should receive a good quality of service.
- consumers should have access to range of tariffs to meet their needs.

Prices and price differentials

4.2. The price that a consumer pays for their energy will depend in part on the extent to which they have engaged with the market and compared the products and services that are available. Differences in price across products may result from a range of factors, including differences in the range of services that a supplier provides;

⁴⁹ See Ofgem (2019, p.16) "[Decision – Framework for assessing whether conditions are in place for effective competition in domestic supply contracts](#)".

differences in pricing strategy or differences in underlying efficiency. Price differentials are a feature of competitive markets as suppliers bid to win and retain consumers across the range of products that they offer. However, a market where many consumers are overcharged is not consistent with effective competition. It means that suppliers do not face enough competitive pressure to constrain their price setting, to operate efficiently and to pass-on these more efficient costs to win and retain consumers.

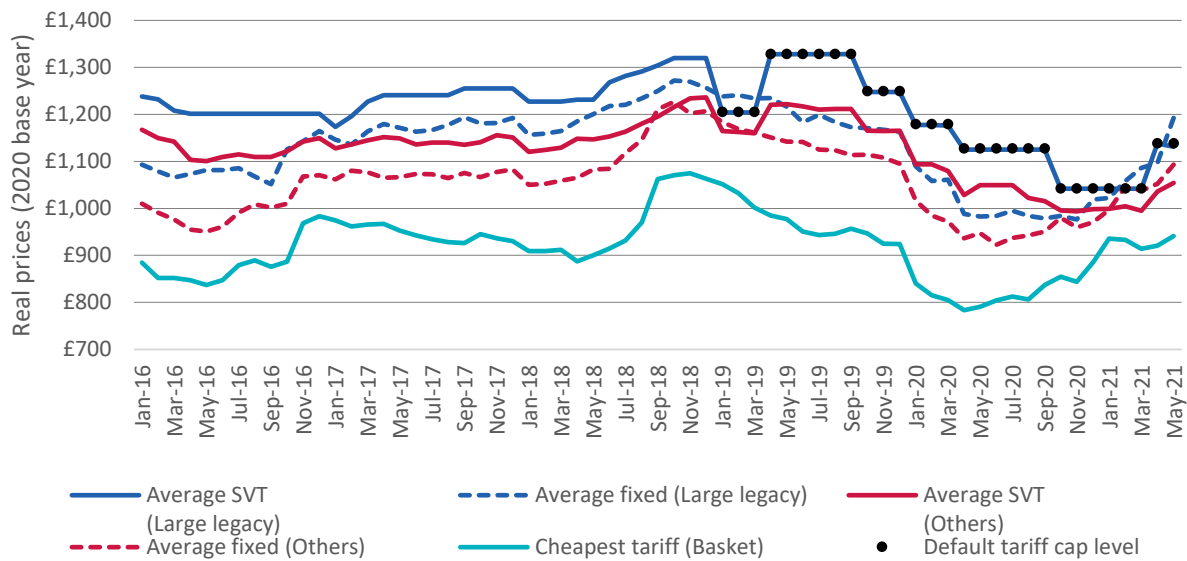
There is no evidence that consumers would be charged fair prices if the cap was lifted

- 4.3. Figure 10 illustrates the evolution of average SVT and fixed tariff prices for large legacy and all other suppliers, across 2016-21. It also shows the average price across the cheapest basket of tariffs available on the market. The default tariff cap level represents a fair price for energy based on estimated costs of supplying energy, and the large legacy suppliers continue to set their SVTs within a few pounds of this level. Other suppliers price their SVTs lower than the default tariff cap level. That might be because they are able to operate more efficiently.^{50,51} Some small suppliers may also be pricing below cost as part of a strategy to grow, but we would expect supplier pricing strategies to adhere to the provisions of the Supplier Licensing Review. Fixed tariff prices have increased over the past year across large and other suppliers, as rising wholesale prices in the second half of 2020 have passed through more quickly to fixed tariffs.

⁵⁰ Part of this difference may be explained by the fact that larger suppliers face certain environmental and social obligation costs that smaller suppliers do not. Some schemes apply to all suppliers, while others only apply to suppliers whose customer numbers and energy outputs pass a given threshold. For example, the Energy Company Obligation (ECO) and Warm Home Discount (WHD) schemes currently apply to suppliers with greater than or equal to 150,000 domestic customers, 300 GWh or electricity supply and 700 GWh of gas supply to domestic customers. The thresholds for these two schemes are falling over time, meaning more suppliers face these costs. For more detail, see Ofgem (2019) "[Environmental Programmes](#)".

⁵¹ Their customers may also differ in how costly they are to serve, though there is limited evidence in this area.

Figure 10: Average prices of SVTs at typical consumption, 2016-2021 (in 2020 prices)



Source: Ofgem analysis of Energylinx (Until May 2017) & Energyhelpline (June 2017 onwards).

4.4. It will take time for the large suppliers to become more efficient and lower their costs to levels that may be more in line with the efficient benchmark in the tariff cap. Overall, there is currently no evidence to suggest that default tariff consumers would be charged fair prices if the cap were removed.

Narrower price differentials between default and fixed tariffs have meant lower potential savings from switching.

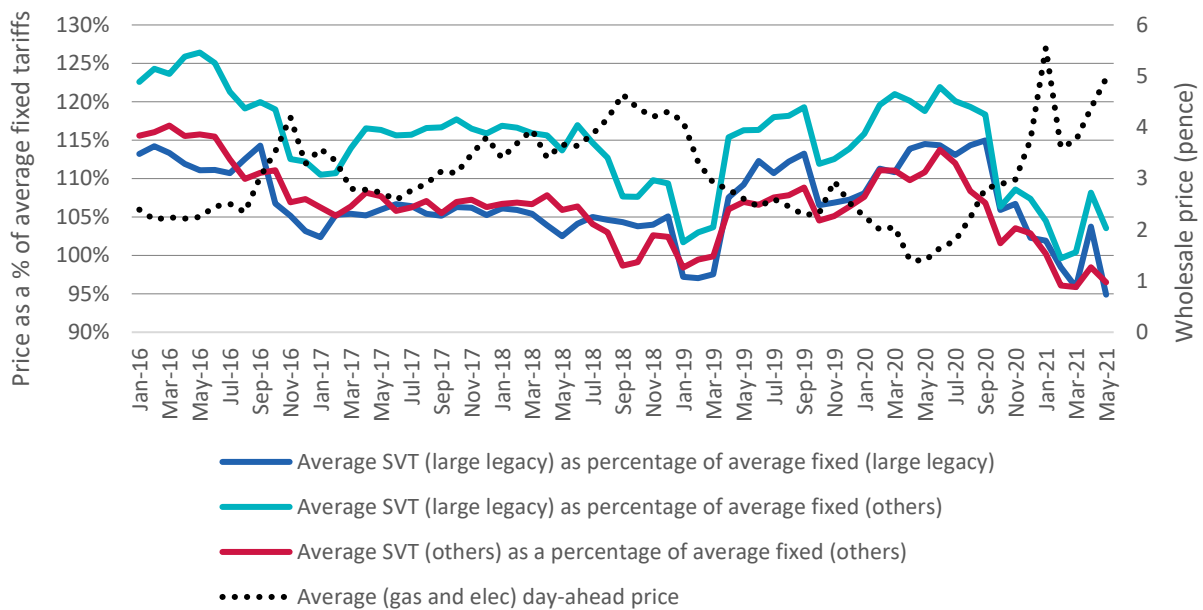
4.5. Price differentials between SVTs and fixed tariffs are driven by multiple factors, including movements in wholesale prices and supplier pricing strategies. We expected that under the default tariff cap⁵² (1) The price differential between SVTs and fixed tariffs would fall, because the cap lowers the price of default tariffs; and (2) price differentials between SVTs and fixed tariffs should become more stable, because suppliers will (on average) purchase their energy closer to the point of delivery for SVTs than they did before the cap, to align with the index used in setting the cap.⁵³ While differentials may be lower under the cap than if it were not in place, we still see significant variation in the size of these differentials. In the first

⁵² See Ofgem (2018) [Decision – Default tariff cap – Overview document](#).

⁵³ This 'shorter' approach will reduce the time lag between wholesale price changes passing into fixed tariff prices, and those changes passing into SVT prices, so making the differential between fixed tariffs and SVTs more stable. See Ofgem (2018) ["Decision – Default tariff cap – Overview document"](#).

half of 2020 we saw that differentials between SVTs and fixed tariffs broadly increased as falling wholesale prices fed through more quickly to fixed tariffs than SVTs. More recently the differential has narrowed (with fixed tariff prices exceeding SVTs) as higher wholesale prices have fed through more quickly to fixed tariffs (see Figure 11). The degree of symmetry between wholesale costs and price differentials is illustrated in Figure 11, which plots SVT prices as a percentage of fixed tariffs.

Figure 11: Price differentials (2020 prices) and wholesale prices



Source: Ofgem analysis of Energylinx (Until May 2017) & Energyhelpline (June 2017 onwards), wholesale prices from Bloomberg ICIS.

Quality of service

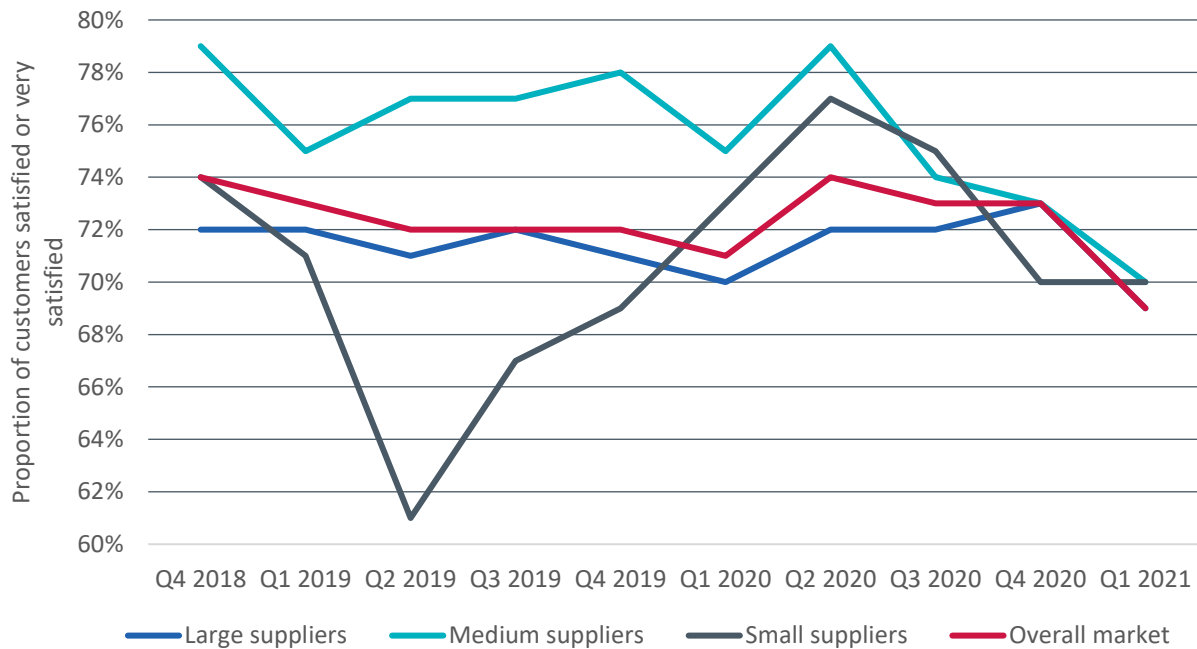
4.6. Competitive markets will also result in different levels of customer service. As set out in our fairness principles, we expect that where competition is effective, consumers receive good quality of service across the range of different degrees of service that they pay for and require.

Customer satisfaction in the market has not changed significantly

4.7. There is no clear trend in how customer satisfaction with the large suppliers, and across the market, is evolving. For example, over the past two years satisfaction levels across the market (and for the large suppliers as a group) have not exceeded their 2018 level. We also note a dip in overall satisfaction across all supplier groups in the most recent available data and will continue to monitor this going forwards

(Figure 12). Medium-sized suppliers have tended to have the highest customer satisfaction, but this has fallen over the past year to levels similar to the market average. Satisfaction among ‘small’ suppliers has been more variable in recent years.

Figure 12: Overall satisfaction with customer service



Note: Up to Q4 2019, ‘large suppliers’ refer to the historic ‘big six’. From Q1 2020, ‘large’ includes OVO. From Q3 2020, ‘large’ also includes Octopus and Bulb. Some of the variation in the figure may therefore reflect this changing composition of categories over time. These results are from the survey question “Overall, how dissatisfied or satisfied are you with the customer service you have received from [supplier name].”

Source: Dedicated quarterly energy satisfaction survey commissioned in 2018 by Ofgem in conjunction with Citizens Advice.

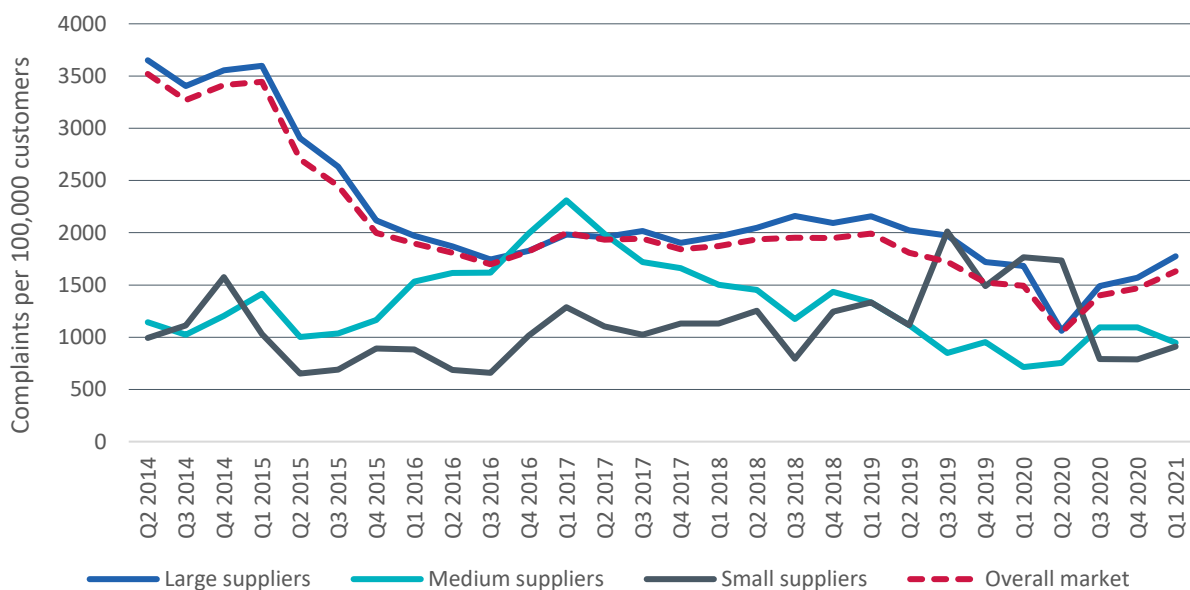
4.8. If consumers are to continue to engage and switch suppliers, an important outcome for them will be their experience of the search and switching process. Our dedicated quarterly energy satisfaction survey⁵⁴ shows that overall satisfaction has not

⁵⁴ Commissioned in 2018 by Ofgem in conjunction with Citizens Advice. See Ofgem (2020) “[Customer service data](#)”.

changed significantly over the past year, with around 15% and 20% of consumers not satisfied with the process for switching and comparing suppliers, respectively.

4.9. The rate of complaints a supplier receives is partly indicative of the quality of its customer service levels. Figure 13 shows large suppliers tend to have, on average, a higher rate of complaints per 100,000 consumers than other suppliers. While complaints with large and medium suppliers reached record lows in the first half of 2020 (since 2014 when data collection began), this was largely due to Covid-19 impacts reducing the amount of contact time consumers have with suppliers. Since then, the rate of complaints for large and medium suppliers has broadly reverted to pre-pandemic levels. The volatility in complaints for smaller suppliers over the past year has been driven in part by the market exit of suppliers with high complaints,⁵⁵ as well as a significant reduction in complaints for one of the small suppliers. Overall, there is no clear downward trend in the rate of complaints on average across the market since the last review.

Figure 13: Complaints per 100,000 customers



Source: Ofgem analysis of supplier data. Data correct as of May 2021.

Consumers continue to have less trust that suppliers will charge them a fair price

⁵⁵ Failed suppliers have typically shown very poor customer service levels, including high complaint rates, prior to market exit.

4.10. Our Consumer Survey results continue to show that consumers are least trusting of suppliers when it comes to being charged a fair price, but levels of trust are higher when it comes to interacting with suppliers and being given clear information.⁵⁶

Range of tariffs to meet needs

More consumers are on smart and 100% renewable tariffs, but clearer tariff information is needed so consumers can make informed choices

4.11. Consumers differ in their preferences and energy needs: an energy market that is working well for consumers will provide a range of different products to reflect these differences.

4.12. Between June 2020 and May 2021, around 60% of the new tariffs launched in the market were labelled as “green” by suppliers, but these do not necessarily always reflect 100% renewable sources.⁵⁷ As set out in our decarbonisation programme action plan, it is important that consumers can trust that tariffs marketed as “green” will make positive environmental impacts on the planet, and that the environmental benefits of a particular tariff or supplier are not overstated (called “greenwashing”). We would expect suppliers to be transparent about what constitutes a green tariff.⁵⁸ As of April 2021, the proportion of consumers on electric tariffs having 100% renewable sources was 43%, which is more than 10% higher than levels seen at the end of 2019.⁵⁹

4.13. We would expect that the range of smart tariffs on offer to consumers will increase as the smart meter rollout progresses further. At the end of 2020, around 15% of consumers were on smart tariffs, up from 13% in 2019.⁶⁰

Overall conclusion: Condition 3 is not yet met.

⁵⁶ The absolute magnitude of our 2020 figures are not directly comparable with previous years, as this year’s survey was conducted online while previous years were face to face. Online consumers are more likely to be ‘market sceptics’ and less trusting in energy companies.

⁵⁷ Energyhelpline data.

⁵⁸ See Ofgem (2020) “[Ofgem decarbonisation programme action plan](#)”.

⁵⁹ Analysis of Ofgem RFI to suppliers.

⁶⁰ Analysis of Ofgem RFI to suppliers.

Appendices

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Appendix 1: Section 7 of the Tariff Cap Act

Section 7 of the Domestic Gas and Electricity (Tariff Cap) Act 2018 sets out the key requirements and timelines for producing this review:⁶¹

- (1) The Authority must carry out a review into whether conditions are in place for effective competition for domestic supply contracts.
- (2) Such a review must, among other things, consider the extent to which progress has been made in installing smart meters for use by domestic customers.
- (3) Such a review must be carried out –
 - (a) in the year 2020,
 - (b) if the tariff cap conditions are extended to have effect for the year 2021, in that year, and
 - (c) if the tariff cap conditions are further extended to have effect for the year 2022, in that year.
- (4) As soon as practicable after carrying out the review, and in any event on or before 31 August in the year in question, the Authority must –
 - (a) Produce a report on the outcome, which must include a recommendation as to whether or not the authority considers that the tariff cap conditions should be extended to have effect for the following year, and
 - (b) Publish the report and send a copy to the Secretary of State.
- (5) After considering the report, the Secretary of State must publish a statement setting out whether the Secretary of State considers that conditions are in place for effective competition for domestic supply contracts.
- (6) The statement must be published on or before 31 October in the year in question.

⁶¹ See [Domestic Gas and Electricity \(Tariff Cap\) Act 2018](#), p. 5.