
Competitive Market Review
A Response by British Gas

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CONTENTS

	Page
Section 1 Executive summary	3
Section 2 Responses to consultation points	4
▪ Customer's experiences	4
▪ Switching Assessment	5
▪ Price non-price offers	6
▪ Profitability Assessment	7
▪ Concentration and indicators of competitive intensity	7
▪ Barriers to entry and expansion	8

1.0 Executive Summary

- 1.1 British Gas welcomes the opportunity to comment on Ofgem's Competitive Market Review (CMR). This response is structured in accordance with the chapter headings of the Competitive Market Review paper.
- 1.2 British Gas is concerned that Ofgem is suggesting that the gas and electricity supply markets remain immature. Market maturity is characterised by a number of indicators that are clearly evident and we believe suggestions by Ofgem to the contrary are unfounded.
- 1.3 Based on the evidence in the review, competition continues to benefit customers in the domestic supply market with awareness levels high, and customer dissatisfaction levels remaining low. Indeed there is also strong evidence of;
- a wide range of consumer choice (through price and non-price offerings);
 - customers exercising choice and their confidence to switch;
 - the growth of partnership and affinity deals demonstrative of a competitive marketplace; and
 - social policy and community care programmes
- 1.4 Competition for domestic market share remains at a high level of intensity. This combined with the increasing prevalence of non-price and differentiated offerings indicates that the supply market is mature.
- 1.5 The UK energy market has developed significantly since liberalisation and therefore the indicators used to measure maturity need to fully reflect the present day market conditions. For example, we believe switching rates should no longer be considered as important as was the case 2-3 years ago.
- 1.6 That said, customer switching is still at a level not seen in most other parts in the UK economy and is a positive indicator to the success of competition in the energy market. By contrast, after nearly 20 years of competition in the telecommunications market, nearly 75 per cent of residential fixed line customers remain with the incumbent, BT.
- 1.7 Non-price offerings (that contribute to the total proposition) are further evidence of market maturity and play an increasingly important part in domestic energy supply competition. This should not be taken as a sign that pressure on suppliers to compete on price is reducing.
- 1.8 Innovation by suppliers is also benefiting fuel poor households. Programmes such as *Warm-a-Life* operated by British Gas are helping customers to tackle the wider effects of poverty and demonstrate suppliers public commitment to addressing issues of corporate social responsibility.
- 1.9 British Gas fully supports the work which Ofgem plans on brand independence and is concerned around the lack of brand/business separation in companies operating both DNO and supplier businesses.
- 1.10 British Gas welcomes Ofgem's proposals to review existing supply licence obligations¹ and we look forward to working with Ofgem in this area which could contribute to a reduction in barriers faced by new market entrants.

¹ 2004-2007 Ofgem Proposed Corporate Plan

2.0 Responses to specific consultation points

Customers' experiences

Awareness

- 2.1 British Gas agrees with Ofgem that customer awareness of supply competition in the domestic energy sector is very high. This is characterised by the fact that around half of all customers have switched supplier, with over 60 per cent of switchers doing so for the first time. Market awareness studies (quoted in the CMR) continue to show high levels of awareness across all social and demographic groups.
- 2.2 Ofgem focuses on prepayment customers having lower than average awareness of their right to switch supplier, but we believe the difference is not significant and awareness is still high.

Fuel Poverty

- 2.3 Programmes such as *Warm-a-Life* operated by British Gas are helping customers to tackle the wider effects of poverty and demonstrate suppliers public commitment to addressing issues of corporate social responsibility. *Warm-a-Life* is assisting vulnerable customers with energy efficiency measures and helping to identify their entitlement to state benefits which can help to offset fuel costs.
- 2.4 British Gas is keen to work with Ofgem, energywatch and the industry on further innovation to assist vulnerable customers. The recently introduced prepayment debt assignment procedure is a good example of how the industry can work together to help provide these customers with access to the competitive market albeit relatively few customers have so far benefited.
- 2.5 British Gas is however, concerned that Ofgem appears focused on barriers to offering specific tariffs to these customers. There are other, more effective ways to protect vulnerable customers (such as energy efficiency advice and measures, priority services and process enhancements to identify specific customer needs) rather than the potentially high costs of social tariffs which are ultimately borne by all customers.

Satisfaction levels

- 2.6 British Gas agrees with Ofgem that publicised accounts of problems within the transfer process, misselling and bill complaints are likely factors in the rise in reported dissatisfaction levels among customers.
- 2.7 British Gas (along with most other suppliers) has seen the total number of energywatch complaints drop over the past year, which can be attributed in part to improvements in the three main process areas mentioned above. Furthermore, British Gas believe that a continued reduction in high publicity complaints will serve to reduce dissatisfaction levels overall, as many suppliers have improved the processes that are most likely to cause customer dissatisfaction. Voluntary schemes such as the accreditation of sales advisers (through EnergySure) and the industry processes to support the Erroneous Transfer Customer Charter demonstrate suppliers' public commitment to tackling key complaint areas, and improving the customer experience overall. British Gas has also embarked on a major business transformation exercise and continues to invest heavily in improving its customer systems to ensure the best possible service going forward.

- 2.8 A high proportion of customers² (switchers and non-switchers) stated they were “highly satisfied” with their energy supplier(s). Customers who were indifferent or didn’t know responded at a ratio of 2:1 to those that were disappointed.
- 2.9 For consideration, market consolidation could have impacted satisfaction levels and may have caused some customers to be less enthusiastic about future switching.
- 2.10 We agree that customer expectations are rising. Critical to the treatment of complaints is ensuring that customers are accurately and appropriately informed of their rights, so that expectations are carefully managed during resolution activity. Consumer awareness of their “right to rights” is most certainly on the increase and it is important that suppliers ensure appropriate access to information for consumers in this area and equally that licence obligations deliver the appropriate outcomes.
- 2.11 British Gas has been working hard to continually improve customer literature, and takes its duty of informing customers of their rights very seriously. However, this needs to be targeted and appropriate (i.e. at the time it is needed/appropriate rather than a blanket approach once a year merely to fulfil an obligation).
- 2.12 As a final point on customer satisfaction, in a competitive market, dissatisfied customers will vote with their feet. Accordingly suppliers with poor complaint records and/or fail to meet customer expectations will see these customers switching away from them. Conversely it is also true that many of the customers remaining with their current supplier do so because they are happy with the service they receive.

Switching assessment

- 2.13 British Gas agrees with Ofgem that switching is an important (though not the sole) indicator of the effectiveness of supply competition and domestic switching rates are supportive of our view that competition continues to operate in the best interests of customers.
- 2.14 Switching rates can no longer be considered as significant as was the case 2-3 years ago. The analysis of traditional markers of competitive activity (such as switching rates) is likely to become more complex in future competitive market reviews. For example, transfer rates may fall due to the Energy Efficiency Trial and the suspension of the 28 day rule. A drop in switching rates could be seen as a reduction in competitive activity, but it should be understood that this effect will be impacted by the up-take of a competitive proposition which offers customers a greater level of choice when selecting a supplier.
- 2.15 Switching activity is invariably a customer driven decision, (supported by the fact that less than 10% of customers surveyed by J.D. Power & Associates³ stated they had been persuaded by a salesman to switch) and suppliers are making use of the many available contact channels to present their energy product offerings. In the doorstep selling arena, great focus has been placed on making information clearer to encourage customer take-up of products. In addition the introduction of the EnergySure accreditation scheme for doorstep sales advisers has encouraged best practice.
- 2.16 British Gas believes there are some issues that continue to hamper the switching experience for some customers in the domestic market, but is not convinced that regulatory intervention is required. The Customer Transfer programme seeks to deliver improvements in the customer experience through the efforts of suppliers working together to address

² 76% of gas customers and 69% of electricity customers questioned in 2003 by J.D. Power and Associates

³ UK Gas Supplier Domestic Customer Satisfaction Study, 2001, 2002, 2003. UK Electricity Supplier Domestic Customer Satisfaction Study, 2001, 2002, 2003.

barriers in this area and we are confident that this will resolve issues that, for some customers, results in switching difficulties. For example:

- One of the key issues which continues to face the industry is data quality - this is a real problem and complicates the transfer process in many cases, leading to delays, registration failures and poor customer experiences. This may also contribute to a lack of customer enthusiasm for further switching when propositioned by an energy supplier.
- Poor customer account data can result in customer payment levels being set too low or too high. The latter cases could, in part, explain why customers state price as their main reason for switching, although in real terms they may not have switched to the cheapest supplier in any given area.

2.17 British Gas fully support the work which Ofgem plans on brand independence. More broadly we are concerned that the lack of business separation within energy companies (that operate DNO and supply businesses) which could lead to the potential for information sharing, and promoting the misconception amongst consumers that quality or security of supply is linked to the supplier.

Price and non-price offers

2.18 British Gas recognises that price, although the main historical reason, is not the sole driver for customer switching decisions, and that customers are increasingly considering additional factors when making a decision to switch, switch back or indeed stay with their current supplier. A much lower proportion of customers state price as the main reason for staying with their current supplier than those stating a non-price reason. A similar proportion of gas customers have no desire to switch (although this was lower in relative terms amongst electricity customers questioned).

2.19 Gas and electricity are a necessity for most of the UK population and many customers are dispassionate about utilities in general. Recent times have seen the introduction of affinity deals, reward schemes and other incentives to encourage customer loyalty and attract new customers. Growth in the prevalence of “non-price” offerings is hardly surprising given that a third of energy customers (overall) state non-price reasons for staying with their current supplier. Using the customer numbers and percentage of switchers quoted in the CMR, the following table is a projection⁴ of the 2002 top five reasons cited by customers who remained with their current supplier:

Customer Movements	Gas	Ele	Combined
Total Non-switchers	11,130,000	12,740,000	23,870,000
Price Non-switching reasons (2002)			
Price/cost	3,672,900	4,204,200	7,877,100
Non-Price, Non-Switching Reasons (2002)			
Satisfied with current supplier	1,113,000	1,146,600	2,259,600
Better customer service	1,001,700	1,146,600	2,148,300
Didn't want to change	3,116,400	3,057,600	6,174,000
Power/supply quality and reliability	2,337,300	1,911,000	4,248,300
Sub-Total (non-price)	7,568,400	7,261,800	14,830,200
% of total non-switchers stating non-price "loyalty" reasons:	67%	63%	65%

Data extrapolated from Ofgem CMR April 2004

⁴ Projection created using data contained exclusively in the Ofgem Competitive Market Review 2004

- 2.20 Non-price reasons for not switching outweigh those that are price related by a ratio of around 2:1. With c.60% of switchers doing so for the first time, it is possible that non-price offerings are increasingly attracting new switchers, which further benefits supply competition in the domestic market (rather than Ofgem's suggestion that incumbents could be using non-price offerings in an attempt to reduce switching and foreclose the market).
- 2.21 The majority of marketing propositions remain focused around price savings, but the role of non-price offerings (that contribute to the total proposition), clearly have an important part to play in the promotion of domestic energy supply competition.

Profitability assessment

- 2.22 Ofgem is right to acknowledge that profits earned fund reinvestment without which, improvements to process, systems and tackling inefficiencies could not be expected to occur at the pace that is required to remain competitive.
- 2.23 British Gas has been investing heavily in new technology and systems to better serve customers. Legacy systems inherited at demerger cannot be expected to manage complex customer relationships at a time where product diversification is an ever present element of the current competitive energy climate. Indeed, energy regulation places demands on suppliers to capture certain types of data or be able to serve or identify a particular customer need, not always readily supported by legacy systems.
- 2.24 Increases in prices are not necessarily an indicator of a reduction in competitor pressures. In fact, this encourages suppliers to differentiate their product offerings in other ways in order to mitigate the effects of wholesale price rises and to gain customers e.g. through affinity deals and reward schemes.
- 2.25 Externalities and their associated costs e.g. wholesale price increases and environmental obligations further encourages suppliers to drive internal cost efficiency measures.
- 2.26 However, as previously mentioned, price is not the sole driver of customer decisions when choosing an energy supplier, and a note of caution should be given to ready criticism of non-switchers. Not all customers have identical requirements or expectations, and companies have to respond to individual needs. Invariably the technical capability required to support this objective comes at a high initial cost, but can be offset by the efficiencies delivered going forward. Indeed, movement between suppliers, attracted by "non-price" incentives as part of the overall proposition, offers customers access to suppliers providing a differentiated product suited to their requirements that would otherwise not be available were "price-only" offerings solely on the table.

Concentration and indicators of competitive intensity

- 2.26 As previously mentioned, British Gas believes that competitive pressures between suppliers remain high. British Gas agrees with Ofgem that erosion of incumbent market shares and supplier moves to differentiate their product offerings reinforces the view that market co-ordination is certainly not apparent in the domestic energy market, and that barriers to new entrants are free from issues of anti-competitive behaviour.
- 2.27 With the departure of Atlantic Gas & Electric, the energy supply market has seen further consolidation. We believe that this demonstrates the competitiveness of the market by showing that prices must be at a sustainable competitive level (a mature competitive

market typically has entry and exit of market participants). Competitive market sustainability must be considered within future market reviews.

Barriers to entry and expansion

- 2.28 British Gas agree with Ofgem that there are many considerations faced by new entrants to the domestic energy supply market. The wide ranging nature of supplier licence obligations in addition to consumer protection legislation which is not always appropriately targeted, is potentially a significant barrier to new entrants. We therefore welcome Ofgem's intention (as detailed in their corporate plan) to review the existing licence requirements for suppliers.
- 2.29 New entry has occurred since the opening of the gas and electricity markets. While there has been some consolidation, it is clear that suppliers have been able to enter the market despite barriers they may have faced. That said, a number of issues and challenges remain that will affect the success of new entrants.
- 2.30 Branding is clearly an important factor for existing suppliers and new entrants, as the ability to identify with customers and promote brand values is a key element of the marketing proposition. Furthermore, differentiation of energy propositions and affiliated services has offered certain suppliers a means to identify with particular customer types and encourage customer switching. The effects of branding may be most felt by existing suppliers and new entrants where they are competing against companies with distribution network operations and supply businesses under the same brand. This in turn, could contribute to customer beliefs that security and quality of supply is somehow attributable to suppliers.
- 2.31 Given recent and historic movements in energy retail it seems most likely that future market entrants will rely heavily on affinity deals, partnerships, white label brand relationships or niche propositioning. It is clear that customers will be increasingly exposed to publicity of competition in the domestic energy supply market through new entrants and the associated marketing reply from established suppliers.
- 2.32 There is significant potential value in developing improved prepayment metering and infrastructure arrangements. We are eager to pursue new prepayment (ppm) solutions and are keen that barriers to innovation and improvement such as the current prohibition on the transfer of debts to a prepayment meter in a new home are removed. Both existing and new market entrants should benefit from such infrastructure enhancements. British Gas looks forward to playing a leading role in their development e.g. introducing competition in the provision of PPM services.
- 2.33 In summary there is very robust competition between suppliers in the domestic supply market, providing a wide range of choice and cost options to an ever-demanding consumer. Entry into the market although feasible, is clearly not a low-cost option for potential new suppliers and will require a reduction of supplier obligations, improvements in the customer transfer process and supplier/industry I.T. systems to help reduce costs.