TARIFF DIFFERENTIALS – SUMMARY OF ANALYSIS TO DATE

As part of its ongoing monitoring of the energy supply markets, Ofgem has recently undertaken further research of the different prices charged to prepayment (PPM) and standard credit (SC)[1] customers compared to those that pay by direct debit (DD). We have also looked at the switching behaviour of PPM customers. The following sets out our analysis to date.

As part of the Energy Supply Probe we will undertake further analysis of the issues outlined in this paper.

Tariff differentials

Figure 1 below shows the difference between average gas and electricity PPM and dual fuel DD and SC bills of the six main suppliers since January 2003. It also shows the difference between average SC and DD bills. The average differential between PPM and DD of the six main suppliers has increased from around £80 at the beginning of 2005 to around £125 now – an increase of more than 50%. Over the same period, the average differential between SC and DD increased from around £40 to £80 – an increase of 100%.

Figure 1: Average tariff differentials between prepayment, direct debit and standard credit

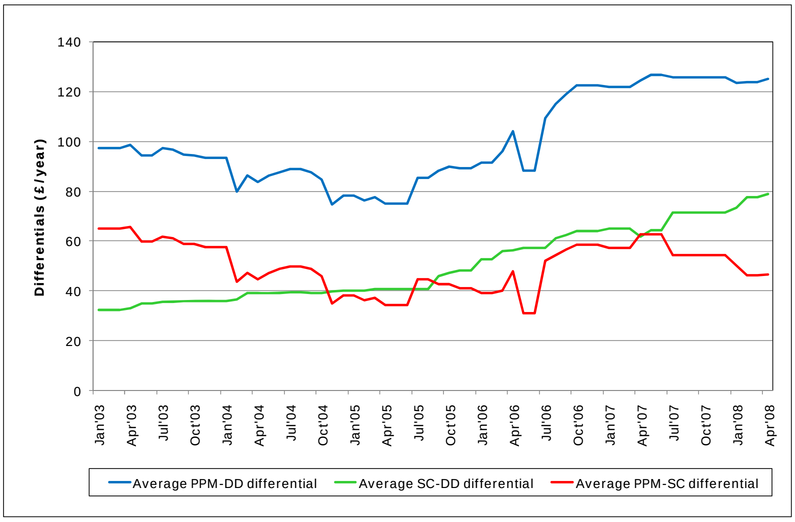


Figure 2 below shows the current difference between each supplier's gas and electricity PPM and dual fuel DD bills. The darker bars show suppliers' lowest regional differential and the lighter bars show the highest. The difference between each supplier's dual fuel SC and DD bills is illustrated in figure 3. Both graphs illustrate that the price differences vary considerably across suppliers, with EDF Energy offering the lowest differential in both cases.

[1] Standard credit refers to where a customer pays on receipt of their bill.

Figures 2 and 3 do not include social tariffs. EDF Energy, SSE, npower, British Gas and Scottish Power each offer some of their vulnerable PPM and SC customers tariffs which are at least equivalent to or cheaper than their standard DD tariffs.

Figure 2: Suppliers' PPM/DD differentials by supplier

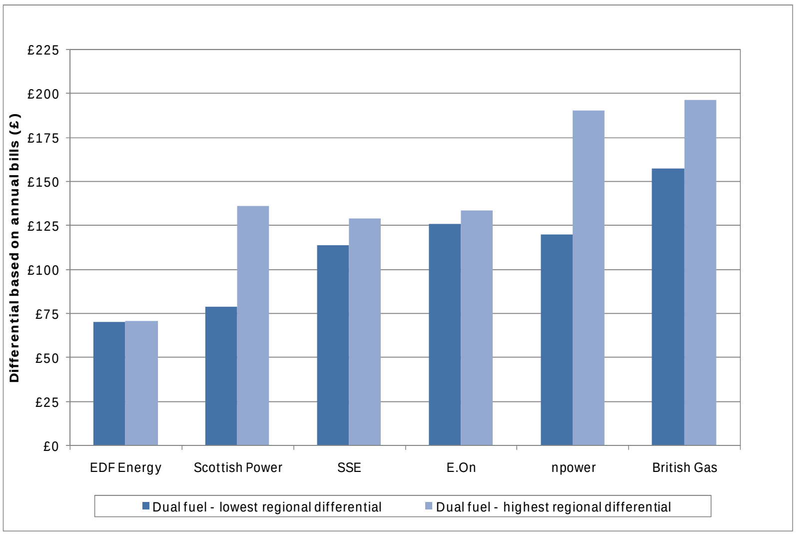
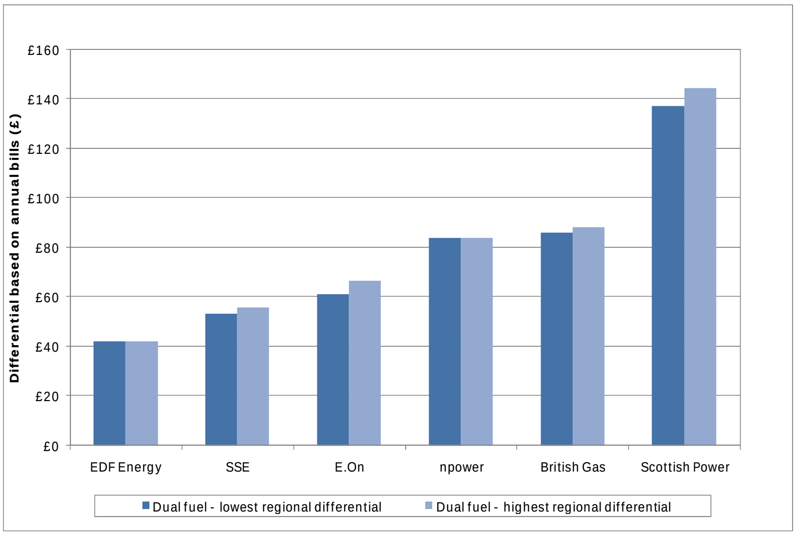


Figure 3: Suppliers' SC/DD differentials by supplier



It is generally recognised that PPM customers are more expensive for suppliers to serve. Based on discussions with suppliers, in June 2007 we published information indicating that the estimated additional cost of serving PPM gas and electricity customers compared to those paying by DD and SC was around £85 and £60 respectively[2]. As part of the probe we will be undertaking further analysis of suppliers' costs to better understand the full cost differences. However, based on our initial estimate, a number of suppliers' price differences are considerably above our £85 estimate of the difference in cost of supplying PPM customers compared to those that pay by DD.

[2] This information was based on discussions with suppliers. The estimated cost differences do not include any differences in suppliers' costs that result from supplying DD and SC customers on a dual fuel basis.

Demographics of those that pay by prepayment and standard credit

The price difference between PPM and DD bills is often linked to concerns over fuel poverty and vulnerable customers. While it is true that PPM customers are more likely to be on a lower income than DD and SC customers, 69%[3] of the fuel poor pay for at least one fuel by SC.

The relationship between PPM and vulnerable customers is also not a straightforward one: while the proportion of customers on PPM tariffs is high among certain groups of vulnerable customers (22% of those with a household income of less than £10,000 pay by PPM), for those over 65 it is below average at only 5%. However, around 36% of those with a household income of less than £10,000 pay by SC and a similar proportion of those over 65 do so[4].

Given this imperfect relationship between prepayment, fuel poverty and vulnerability it is essential that any amendments to the current arrangements consider both PPM and SC issues.

Switching behaviour

Savings available to PPM and SC customers that have never switched supplier are greater on average than those available for DD customers. On average across all regions, a PPM customer that has never switched their gas and electricity can save around £125 by switching to the best deal, while SC customers can save around £90. This is significantly above the savings available to DD customers of around £55. In some regions, PPM customers that have never switched their gas and electricity can save over £200. In light of the savings available, switching is still an important way customers can save money.

There has been concern in the past that PPM and SC customers were not participating in the competitive market to the same extent as customers that pay by DD. In particular, previous research indicated that the proportion of PPM and SC customers who had switched was below average and was particularly low compared to customers paying by DD (see figure 4). However, more recent evidence suggests that in 2007 PPM customers switched at least as much as those that pay by DD, while SC customers still switched less frequently (see figure 5).

Figure 4: Percentage of customers that have switched supplier (2005)

	Gas	Electricity
All customers	46%	47%
Direct debit	54%	55%
Prepayment	36%	41%
Standard credit	34%	36%

Source: Accent 2005

[3] Estimate for 2006 based on the 2004 English House Condition survey. The data is included in the Fuel Poverty Advisory Group's 2007 annual report.

[4] These figures are based on the Accent 2005 survey commissioned by Ofgem.

Figure 5: Percentage of customers that switched supplier in 2007

	Gas	Electricity
Direct debit	21%	21%
Prepayment	23%	20%
Standard credit	13%	12%

Source: Ipsos Mori 2008

While it is encouraging that PPM customers are switching more, we have found evidence that some of this switching is to more expensive suppliers. On the face of it, we would expect to see customers switching away from the relatively expensive suppliers and towards the less expensive suppliers, particularly as 78% of customers say their main reason for switching supplier is to save money. However, information from suppliers about their PPM gains and losses does not show such a perfect relationship. In 2007 63% of electricity and 56% of gas PPM transfers went to the 3 most expensive suppliers.

There may be a number of reasons why this is happening. Customer survey results from our recently commissioned Mori survey indicate that doorstep and phone sales play an important part in customer switching as illustrated in figure 6, particularly for PPM customers. This information taken with evidence that some PPM customers may be switching to more expensive deals highlights the importance of customers being sold to through the doorstep and sales route being given full information. We will look at this issue more as part of the Energy Supply Probe.

Figure 6: Method of finding out about the supplier's offer

	Switching site, phoned the supplier & phoned a range of suppliers	Doorstep & phone sales
All	29%	47%
Direct debit	33%	44%
Prepayment	9%	70%
Standard credit	26%	43%

Source: Ipsos Mori 2008