



Making a positive difference
for energy consumers

To: Domestic suppliers,
consumer representatives,
academics and other interested
parties.

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Domestic Retail Market Review – Evaluation framework and baseline results

The Retail Market Review (RMR) reforms are now in place.¹ They aim to promote engagement and improve competition by making the domestic retail market simpler, clearer and fairer for consumers. It is vital that we track the impact of these measures. This letter sets out our approach for doing so and some baseline results, which we will use in the future to compare changes over time.

In January 2014, we consulted on a high-level framework for our evaluation.² We have received broad support from stakeholders on our approach and will therefore adopt it for assessing the impact of the RMR in future. More broadly, we will report annually on the progress of competition in retail markets. The first of these assessments was published in March this year.³ Our work to understand the impact of the RMR on consumer engagement will be an important component of future reports. From 2015 onwards, the reports will include our RMR evaluation, updated supplier metrics and liquidity indicators. We hope that the 2015 report will provide useful insight for the Competition and Markets Authority's ongoing investigation.

An essential element of our evaluation framework is establishing a baseline of evidence to help us understand how consumers were engaging with the market before they had chance to take account of our reforms. Our 2014 State of the Market assessment provides one aspect of that baseline. To complement this, we have carried out new consumer research, including a major survey, to establish a robust baseline of consumer attitudes and behaviour. The results of this survey are published alongside this letter. Later in the year, we will publish additional qualitative insight from research conducted with our Consumer First Panel.

The RMR is primarily designed to influence consumer behaviour and attitudes and, in doing so, to improve how the retail market functions. We expect changes in consumer engagement to be more pronounced year on year. Over the course of the evaluation, we will be monitoring closely how suppliers are complying with these new rules and any developments in competition very closely. The results of the evaluation will guide our review of the RMR package, planned for 2017. We acknowledge that arrangements designed to help consumers engage in today's market may need to adapt to the opportunities and risks that smart metering presents. With this in mind, we will keep these arrangements under review and stand ready to take action where and when appropriate.

¹ For a complete timeline of RMR measures, and the details of the package of remedies, see *The Retail Market Review – Final domestic proposals*, 27 March 2013. Available [here](#).

² See *'Domestic Retail Market Review evaluation – A proposed way forward'*, 14 January 2014. Available [here](#).

³ See *'State of The Market assessment'*, 27 March 2014. Available [here](#).

The annex contains a summary of stakeholder views on our approach, the results of the baseline consumer survey and our initial views on a modelling approach for the evaluation.

If you would like to comment our proposed modelling approach set out in the annex, or discuss any of the issues raised in this letter, please send them to Jemma Baker at RetailMarket.Review@ofgem.gov.uk.

A handwritten signature in black ink that reads "NBarnes." The signature is written in a cursive style.

Neil Barnes
Associate Partner, Retail Markets

Annex

This annex includes four sections. In section 1, we briefly summarise the background to the RMR evaluation. Section 2 presents stakeholders' responses to our January open letter and our views. Section 3 highlights the main findings of the baseline survey report attached to this open letter. Finally, section 4 provides initial views on our statistical modelling approach for understanding how different parts of the RMR package are contributing to key engagement outcomes.

1. Background

In January, we outlined our framework for monitoring and evaluating the impact of the RMR reforms on consumer engagement with the retail market. Our aim is to understand whether our rules have contributed to improving consumer engagement in relation to three broad objectives: building trust, improving understanding of supplier communications and simplifying tariff choices. In particular, this framework will allow us to:

- **Measure changes over time** compared to the baseline set before the entire package was in effect. We will use previous data, including our 2014 State of the Market assessment, and our new consumer research as the baseline for future comparisons. We will measure these changes by combining the findings from analysis of a range of data sources, including consumer research (quantitative and qualitative) and supplier metrics.
- **Use consumer research to support statistical analysis** to understand which factors could be associated with the changes we are observing, and to what extent they are likely to be associated with our policies.

Our work to understand the impact of the RMR reforms on consumer engagement will be an important component of our 2015 State of the Market assessment.

2. Stakeholder responses to the open letter and our views

Respondents to the January open letter were broadly supportive of our evaluation framework.⁴ In particular, the majority of stakeholders agreed with our general analytical approach. They thought our framework was appropriate for assessing the impact of the RMR. A number of respondents requested certain clarifications, which we address here.

State of the Market 2015 - Some stakeholders asked about the relationship between the RMR evaluation work and our 2015 State of the Market assessment. We would like to clarify that next year's assessment will include our first RMR evaluation report. This will help us analyse the emerging impact of RMR reforms on changes in the demand side of the retail market.

Policy development - Respondents also questioned how the evaluation will feed into policy development ahead of the planned review of the RMR in 2017. We would like to reassure stakeholders that our monitoring and compliance activities will help us to identify potential problems with the functioning of our rules. We also acknowledge that arrangements designed to help consumers engage in today's market may need to adapt to the opportunities and risks that smart metering presents. With this in mind, we intend to keep the arrangements under review and are ready to take action where necessary.

External factors - Some stakeholders requested clarification on how our framework would account for the effect of external influences, such as media coverage and political decisions, on consumers' behaviour and attitudes. We agree with stakeholders that it is important to

⁴ Responses to the January open letter can be found [here](#).

consider such external influences. Our evaluation will not be conducted in isolation. It is part of a broader assessment of the progress of competition in retail markets. Similarly, the consumer research that will feed into the evaluation accounts for a range of drivers of behaviour and opinion, not just those within the RMR package.

Baseline for the evaluation - Some stakeholders questioned using our new consumer survey as a baseline for evaluating the RMR on the basis of its timing. More specifically, they wanted to understand how the survey will measure the full impact of the RMR reforms given that some suppliers aligned their offers to the new rules in advance of the official implementation dates, and as a result the RMR could have started to influence the market before 2014. We recognise that some suppliers began to comply with certain RMR remedies before the deadlines. We would like to reassure stakeholders that, besides the 2014 consumer survey, other sources will be used to assess the impact of early stages of the RMR implementation, including the State of the Market 2014 report, our annual Ipsos MORI tracking survey reports⁵ (which date back to 2008) and our qualitative evidence base. We consider the 2014 consumer survey a robust addition to our baseline for the evaluation exercise.

Details of the evaluation - Some respondents raised concerns that our approach did not contain enough detail for them to comment on the way forward. If stakeholders have further views in light of the full survey published today, we can consider these ahead of our first evaluation report in 2015. We are planning to make minor revisions to next year's survey questionnaire, to reflect the fact that the full package of rules has now come into effect. For this year, some questions which were not included in the baseline survey have been subsequently addressed through qualitative consumer research.

Unintended consequences - Finally, some respondents questioned whether our framework captured all possible unintended consequences of the RMR measures. In our workshop in December 2013, we worked with stakeholders to develop a detailed list of both desired outcomes of the RMR reforms and potential unintended consequences. The responses we received to our January open letter did not highlight anything which was not captured within this workshop. We would like to reassure stakeholders that while our open letter provided a high-level summary of these, our evaluation will take account of the detailed listed discussed with them.

3. Key findings of baseline survey

The baseline consumer survey was conducted between 13 March and 5 April 2014, at a time when the full RMR reform package was not yet in place. It involved more than 6,000 energy consumers in Great Britain. We used the survey to investigate consumer *awareness* of the saving possibilities available in the retail market and their engagement: from reading a supplier communication (*access*) to comparing available tariffs (*assess*), changing tariff and switching supplier (*act*). It also collects data on consumer confidence, trust and understanding of the market.

Communications - According to the survey, most consumers recall receiving communications from their supplier over the last 12 months (most commonly a bill or annual summary). The majority found them to be very or quite clearly presented. Among those who received one, the end of fixed-term notice is reported as the most effective trigger for consumer action of all the communications examined.

Tariffs - Our survey shows engaged consumers are more likely to consider there is too much choice in the market. The opposite holds for ease of tariff comparison, where the less engaged consumers are more likely to consider comparisons difficult. Overall, among those with recent comparison experience, nearly a quarter thinks it is easier to compare tariffs than a year ago, although the majority did not notice any changes.

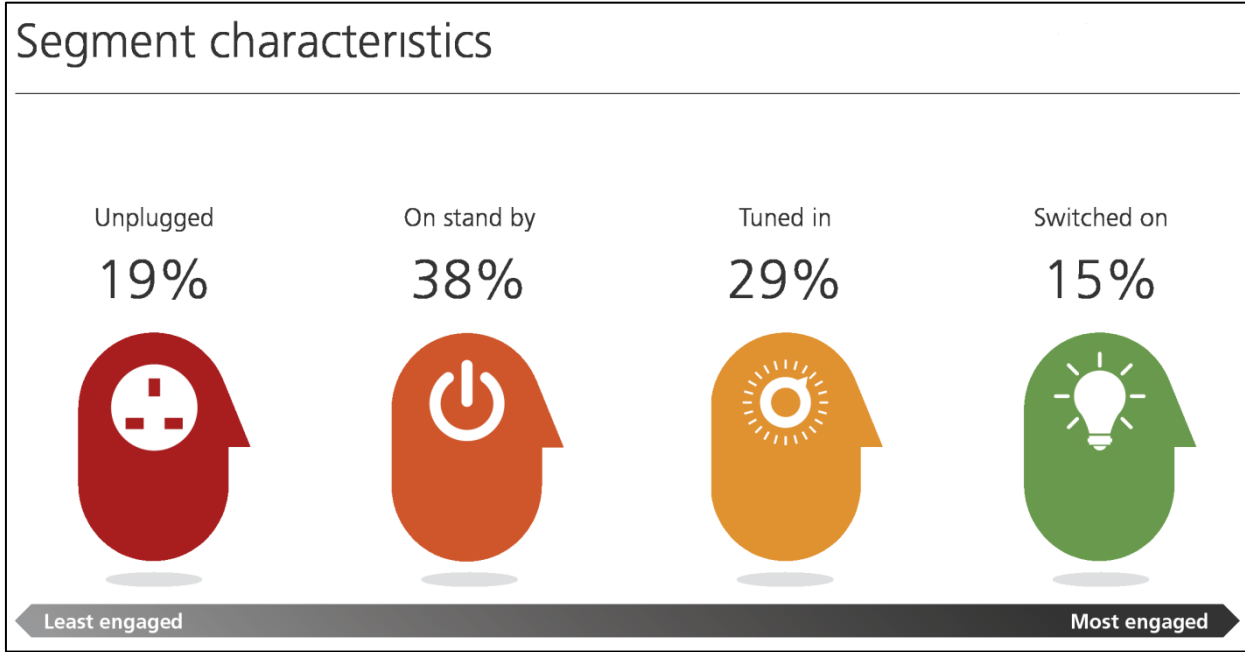
⁵ The 2014 report is available [here](#).

Trust - The survey shows that trust in energy suppliers and the market is a complex area. Consumers tend to trust their own supplier and trust them more than the industry as a whole. However, the energy market is trusted less than many other sectors, including water supply, landline telephony and banking. The survey also suggests that the more engaged a consumer is, the less likely they are to trust energy suppliers.

General indicators of engagement - The survey shows that most consumers are aware they can switch supplier or change tariff with their existing supplier. Around 14% of consumers switched supplier over the last 12 months, and 16% changed tariff without changing supplier. The main reason for comparing suppliers or tariffs is to save money, and such activity is mainly triggered by supplier communications. Most of those who switched found it relatively easy to decide which tariff to switch to. However, many consumers remain unengaged in the market, with 39% finding it difficult to compare tariffs. Just over half of consumers are confident they are currently on the best deal for them.

Index of engagement - Besides the general indicators of engagement, the survey findings enable us to build an index of engagement. Specifically, we used consumer *awareness* and *actions* in the energy market (for instance, switching supplier or tariff, comparing tariffs, reading a bill) to create an index of engagement. From that, we identified four distinct segments which we will be able to track in future years to see whether the size and characteristics of each group change.

Figure 1: Consumer Engagement Index



The four groups are, in increasing order of engagement, *unplugged*, *on standby*, *tuned in* and *switched on*. The survey identifies the socio-economic and attitudinal characteristics of the consumers belonging to each group. For example, consumers in the 'unplugged' segment are more likely to be in lower social groups, aged over 65, live in social rented accommodation, pay their bills by prepayment meter and have limited internet access. More generally, they have a low awareness of the saving possibilities available and low confidence in navigating the market.

To complement this baseline survey, later this year we will publish the findings from bespoke qualitative research carried out with our Consumer First Panel. This will add further detail to the consumer segmentation and illustrate consumer awareness and perceptions of the key RMR measures.

4. Our proposed modelling approach

The evaluation work is more than simple descriptive monitoring. The statistics presented in the previous section, if taken in isolation, are not sufficient to assess whether the behavioural changes we may observe are positively associated with the implementation of RMR rules. We are therefore considering different types of statistical analysis that might help us to assess the impact that the RMR measures has on the three primary RMR objectives and, ultimately, consumer engagement.

We are currently considering two types of econometric models: the first one, *logistic regression*, aims to identify which factors are likely to be correlated with key RMR outcomes. The second one, *path analysis*, aims to quantify the strength of the association between each of the RMR objectives and each consumer's score on the engagement index.

Here they are described in more detail:

- 1. Logistic regression** might allow us to identify which factors (including socio-demographic factors as well as attitudes and engagement with the energy market) are associated with positive RMR outcomes (e.g. finding it easy to compare tariffs, taking action on communications received, familiarity with tariffs, and trust in energy suppliers). As an example, a logistic model could tell us what bearing "Recalling any negative press about energy companies" has on the likelihood to "Trust your energy supplier to treat you fairly".

We recognise that it is very difficult to establish causal relationships between individual factors and RMR outcomes, in particular since the relationship between them may be both ways (the so called 'endogeneity bias'). We will therefore focus on increasing the robustness of this model and, potentially, consider alternative econometric approaches that could be valid in such circumstances. Since we will collect the same survey data in the coming years, we might consider approaches that rely on changes over time to assess the importance of different factors for RMR outcomes (such as *fixed effects* models and *difference-in-difference* estimation).

- 2. Path analysis** is a method that allows us to examine whether some factors are influencing intermediary factors before, in turn, influencing the ultimate outcome of interest (eg engagement in the energy market). Again, the existence of potential bi-directional relationships may require more complex approaches.

The benefit of using path modelling is that it explicitly captures the relationship between different factors which contribute towards a set outcome. In many circumstances, in fact, not all explanatory factors affect the outcome directly. Many of them could interact with one or more intermediary factors, which in turn affect the outcome variable. Path modelling may therefore help us to identify the underlying path of influence between the factors and the outcome.

We will work on our approach to statistical modelling in the coming months and welcome stakeholders' view and comments on this analysis. Depending on these responses we may further engage with stakeholders in the near future to discuss our modelling approach.