

Ofgem
10 South Colonnade,
Canary Wharf,
London, E14 4PU
Email: CDconsultations@ofgem.gov.uk

21 June 2019

Dear Sir/Madam,

Call for Evidence: Strategic Review of the microbusiness retail market

FSB welcomes the opportunity to respond to the above mentioned consultation.

Introduction

FSB recently carried out an energy market survey of 1342 FSB small businesses. Of these, 1082 were microbusinesses. The data presented in this consultation response has been further tailored to exclude microbusinesses that are home-based, mobile (i.e. no permanent premises), or do not have a metered business electricity or gas account (leaving a residual 712 respondents).

60% of these microbusinesses say energy is a 'significant' cost. And 35% describe their business energy use as 'relatively intensive'. So the opportunity to reduce costs and save money is, for many, an attractive proposition in principle.

Energy is an expensive commodity, but the relationship that microbusinesses have with their energy varies, depending on the exact nature and circumstances of those businesses. So what constitutes a 'fair' cost for that energy depends on the holistic range of opportunities and benefits that microbusinesses receive in return. Such benefits may include opportunities for carbon reduction and energy efficiency, microgeneration, long-term security and risk-reduction. So what do microbusinesses actually want to pay for?

Following the completion of the recent Competitions and Markets Authority (CMA) investigation into the retail energy market, FSB broadly welcomed many of the proposed remedies, particularly the development of published, comparable prices for microbusinesses. However, we remained concerned that the publication of prices alone would do little to improve the market if those published prices were not also comparable. This concern has subsequently been realised.

FSB also raised concerns that, beyond looking at a fair cost, the CMA investigation did not extend to looking at how the retail market could also empower customers to use less energy or choose how and where their energy is generated. Energy reduction is the single

best way that small businesses can save money on their bills, yet the post-CMA market is still not well placed to drive and support this behaviour change.

Question 1: Do you agree that our theories of harm (see earlier in this document and Annex 2) represent the most significant and impactful areas of consumer detriment?

FSB fully agrees with theories of harm as set out in Annex 2. However, we would urge caution around treating all microbusinesses the same, both in terms of the degree to which these theories of harm are relevant and which remedies are required. We have set out below how relationships with the energy market vary for different microbusinesses in different situations. Market segmentation is critical.

We have also set out our thoughts, and present new data, on issues such as market engagement, access to consumption data, price transparency and TPIs.

Question 2: Are there any other key areas of consumer harm that should form the focus of our review?

FSB acknowledges the parameters of Ofgem's consultation into the microbusiness energy market, in so far as it focusses on the market as it is today. However, the smart energy market of the future will be a very different environment. The degree to which smaller firms will be able to take advantage of any future market will, in a large degree, depend on the opportunities and investments they seek today and the threats they face. In this sense, the idea of current 'market failure' should include the failure to prepare customers for the future.

For example, according to recent FSB data, **only 22% of microbusinesses say they have a smart or advanced meter installed**. This figure is higher for those based in industrial workshops (39%), many of which are likely to be relatively more intensive energy users, and those based in premises attached to their home (22%). However, the figure is much lower for those based in business parks (15%), private offices (11%), and multi-occupancy offices (5%).

Microbusinesses are ill-equipped to make decisions today that will enable them to thrive in the smart market of the near future. They threaten to be left behind.

Question 3: Do you think awareness raising materials/initiatives would be of significant benefit to microbusinesses? What key information should any new materials focus on and how would they best be delivered to microbusinesses?

FSB recognises the progress made by suppliers to improve their communication with customers, particularly around end of contract and renewal periods. However, FSB data

suggest that **only around a third (33%) of microbusinesses believe their current supplier communicates with them effectively.**

Question 4: Our evaluation of the CMA’s price transparency remedy (published alongside this document) has identified a number of issues at this stage of the customer journey. What do you see as the most impactful issues hindering microbusinesses attempting to effectively browse the market in search of an improved deal/service offering? Please provide quantitative and/or qualitative evidence demonstrating why you believe these issues to be most impactful.

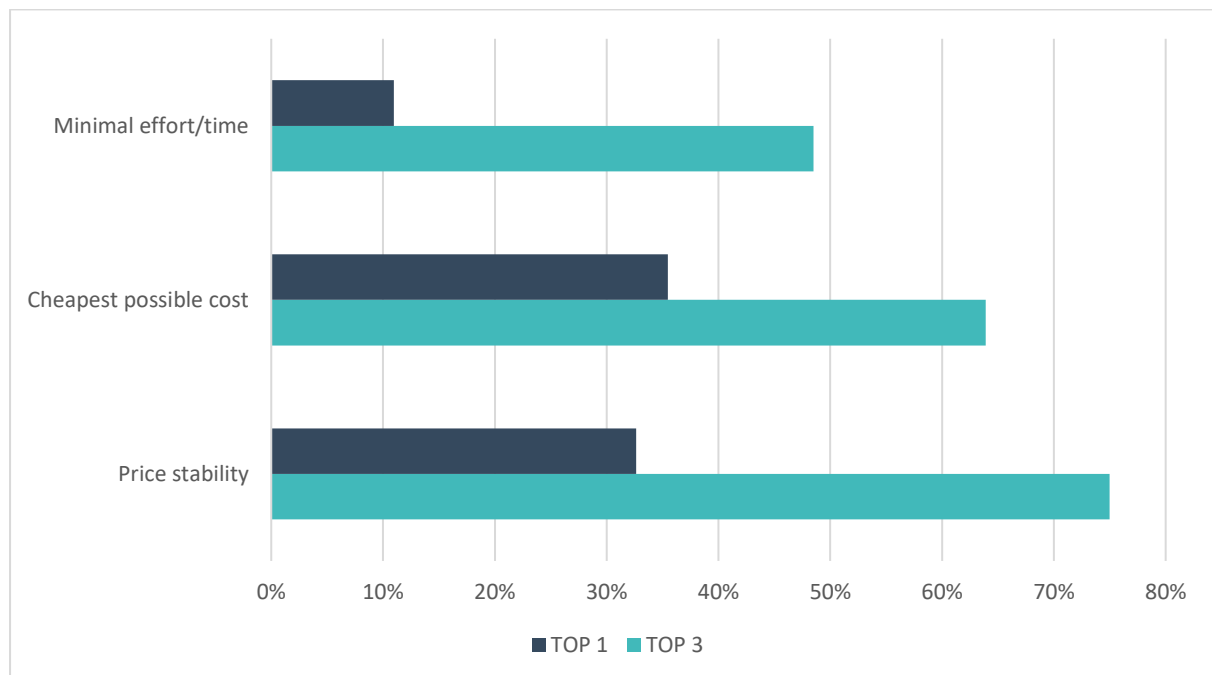
Recent FSB research (Figure 1) suggests that the **most important considerations when choosing an electricity provider for microbusinesses are:**¹

- **Price stability**
- **Cheapest possible deal**
- **Minimal effort**

However, customer service (top 3 considerations for 29%), trust in the brand (top 3 for 28%) and renewable sourced energy (top 3 for 14%) were important considerations for many small firms, reflecting their diversity.

Figure 1: Most important considerations when choosing an electricity provider for microbusinesses

Source: FSB energy market survey, 2019



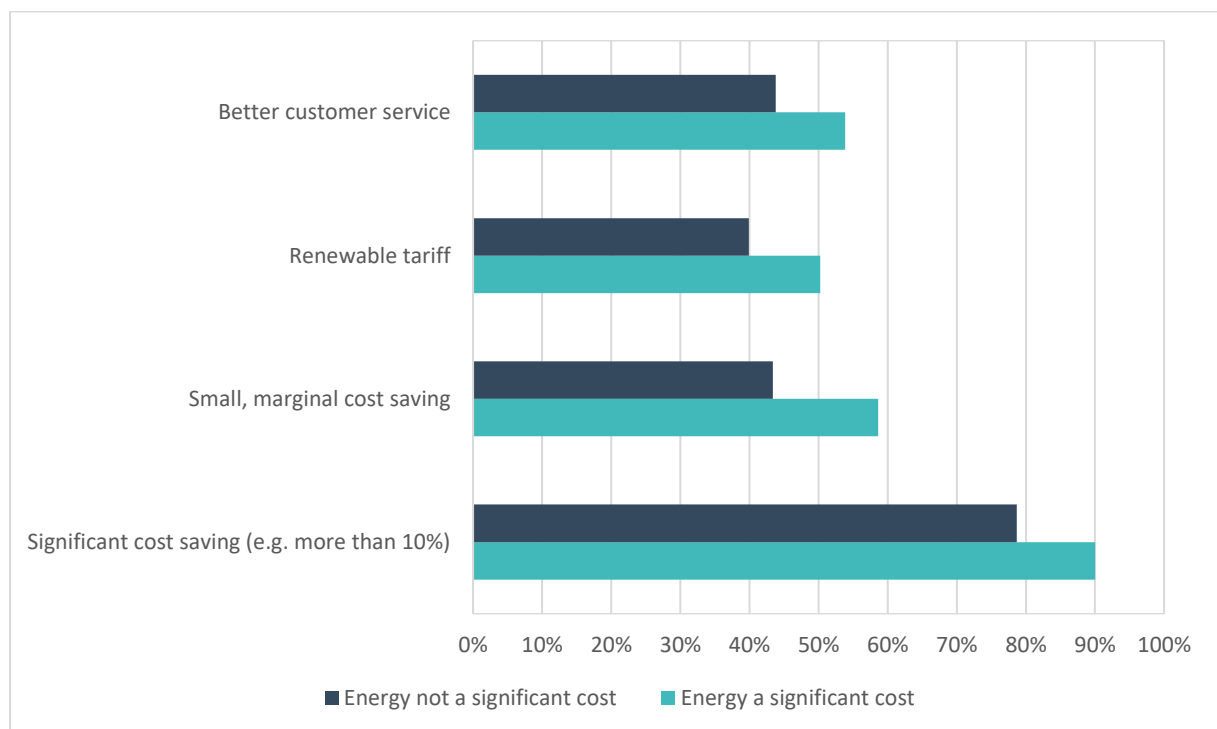
¹ FSB Energy & Broadband Survey, 2019

However, microbusinesses are a diverse audience so it would be wrong to assume that they all desire the same things or that a one-size fits all solution exists to fix the challenge of low market engagement. FSB has long called for better market segmentation of small and microbusiness customers in the energy market. The broad definition of 'microbusiness' includes intensive energy customers using industrial processes, office-based firms that use small amounts of energy for operating laptops and boiling the kettle, and vulnerable businesses struggling to pay their bills. The reason that segmentation is important is that the motivations of microbusinesses in the energy market vary, depending on their circumstances.

Figure 2 shows that more intensive energy users tend to be more interested in the potential for marginal cost savings, but also the wider market benefits across the board. Lower end users, conversely, appear to be less motivated, almost certainly reflecting the high opportunity costs of their market engagement and their perception of low relative benefits.

Figure 2: Microbusiness views on what would motivate them to switch to a new energy supplier

Source: FSB energy market survey, 2019



Access to Data

Access to data is vital for microbusinesses and will only become more important as we move rapidly towards a smarter, and potentially more complex market. If energy use

cannot be measured accurately, then small firms cannot make evidence-based choices about the best energy deal for them. Microbusiness customers must be empowered to understand and choose what services they pay for, where they can find the best deal, where they can save energy, and where and how their energy is generated. In this context, therefore, it is absolutely critical that microbusinesses – and those operating on their behalf – have timely and secure access to consumption and usage data.

Previous FSB research showed that **33 per cent of FSB small businesses believe that energy efficiency savings will offset the increasing cost of their energy, as opposed to just 23 per cent who don't think this will be the case.**² So, small businesses need support and information to help make these savings wherever possible. The role of data, in this regard, is vital.

FSB is supportive of smart meters, believing they are the vital first step to a smart energy market. However, simply installing this new hardware won't automatically provide any benefits to customers. Instead, the benefits of smart meters will only be realised with the changes to the market, and the resultant changes to customer behaviours, that this technology empowers. FSB wants to see the emergence of a new, smart energy market that acknowledges a diverse customer base and enables smaller businesses to make holistic decisions. But the foundations for that future market must be set today.

However, according to recent FSB data, **only 22% of microbusinesses say they have a smart or advanced meter installed.** This figure is higher for those based in industrial workshops (39%) – many of which are likely to be relatively more intensive energy users – and those based in premises attached to their home (22%). However, the figure is much lower for those based in business parks (15%), private offices (11%), and multi-occupancy offices (5%).

FSB believes there has been a lack of clarity from energy retailers, Government, and regulators, around what a smart market might actually look like for microbusinesses. The focus of retail energy companies has, perhaps understandably, been on rolling out SMETS1 meters to domestic customers in order to meet Government's ambitious deadline. The emphasis has been on the roll-out of the hardware itself, with little thought as to the products and services that customers will be offered by suppliers in future. Customers are currently faced with all of the disruption and costs without any understanding about what benefits (and, for some, risks) a smart energy market will eventually bring. This adds to the sense of disempowerment and disengagement of customers, including microbusinesses.

So microbusiness customers need clarity about what a future smart energy market should look like. FSB has attempted to fill this gap via the publication of two reports – the Price of Power (2017) and Open Energy (2018)³. But further research is required. At the moment, the pervasive view among policy makers and industry operators is that the market will eventually decide for itself what it will provide smart customers in future. In

² FSB, The Price of Power, 2016 – available at: www.fsb.org.uk/docs/default-source/fsb-org-uk/energy-report--jan-04-2017.pdf?sfvrsn=1

³ <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-open-energy-report-final.pdf?sfvrsn=0>

which case, it is unsurprising that many microbusiness customers remain sceptical, based on their experiences of the market in the past.

Question 5: What do you see as the key issues microbusinesses face when they come to enter into a new contract for their energy supply? Please provide quantitative and/or qualitative evidence demonstrating the extent and impact of the consumer harm caused by these issues in the form of both financial and non-financial detriment.

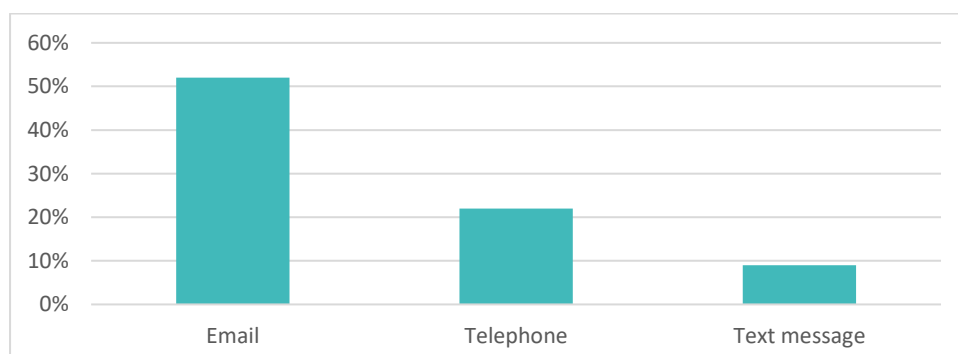
Microbusinesses tend to be short of time, money and resource to cover activities outside of their core business. However, recent FSB research suggests that **52% of microbusinesses expect to switch supplier when their current contract expires.**

FSB has long been supportive of published, comparable tariffs for small firms, believing that they can reduce opportunity costs for many businesses. However, we also support Ofgem's current view that many businesses, including microbusinesses, continue to prefer bespoke arrangements. This is a point we previously raised with the CMA in supporting calls for published tariffs. We do not see published tariffs and bespoke negotiations as mutually exclusive. Rather, published tariffs provide a quick and easy option for those for whom the opportunity cost of engagement is relatively high. And they also provide a starting point or baseline for those that see relative value in spending additional time and resource engaging in the market.

FSB recognises Ofgem's view that the dual nature of the market means that quotes generated through the tools on suppliers' websites are not typically seen as the final or best prices, which in turn may negatively impact consumer trust. However, we do urge caution around another of Ofgem's suggestions that microbusinesses tend not to use suppliers' websites to any great extent because they prefer to use the phone for negotiations. This may well be true, but new FSB data suggests that email is the preferred communication option for many business (Figure 3).

Figure 3: Types of supplier contact most likely to persuade microbusinesses to invest time/resource in switching

Source: FSB energy market survey, 2019



On the one hand, email gives microbusiness owners the time and space they may need to make decisions. In this regard, we acknowledge the microbusiness case study provided in Ofgem's Evaluation of CMA Price Transparency Remedy, which states that, *"The landline constantly rings with companies I've never heard of and it's always at the time I'm serving customers so I get very cross."* This is a view no doubt shared by many smaller firms.

On the other hand, however, email may simply make it easier for microbusinesses to delay these decisions and avoid difficult market engagement.

Microbusinesses are a diverse audience and there is a pressing need for energy suppliers to understand their customers better. This is a point that was highlighted in evidence to the CMA, where it became clear that most suppliers only segmented by "SME", which includes anything from a sole trader to a household brand with up to 250 employees. How microbusinesses choose to interact with the retail energy market depends on a number of factors, including:

- 1) The relative cost of their energy, compared to other costs like staff wages, plant and machinery, rent, tax etc.
 - **60% of microbusiness say energy is a significant cost.**
 - **35% say their business is relatively energy intensive.**
 - **53% say a small, marginal saving would persuade them to switch provider.**
 - For energy intensive users this increases to 59%
 - For non-intensive users this drops to 43%.
- 2) Satisfaction with their current supplier/contract
 - **59% of microbusinesses say they are broadly content with their current energy contract.**
 - **59% say their current energy deal is fairly competitive.**
 - **39% say their energy supplier provides a decent all-round service.**
 - For those that actively renegotiated their previous contract, this rises to 53%
 - For those that automatically rolled over their previous contract, this drops to 21%
 - **25% believe their current supplier does not value them as a customer.**
- 3) The difficulty (real or perceived) of engaging with the market, including trust in outcomes, i.e. the belief that their engagement is worth their while.
 - **12% of microbusinesses say they regret signing up to their latest contract.**

Figure 4 shows how, just using these three basic factors, we have already identified eight different microbusiness types in the market place. In reality, there are many other factors to consider when trying to better understand microbusiness customers.

Figure 4: Types of microbusiness customer in the energy retail market

Source: FSB energy market survey, 2019

HIGH energy use / HIGH cost (relative)			
High satisfaction with current supplier/contract	High satisfaction with current supplier/contract	Low satisfaction with current supplier/contract	Low satisfaction with current supplier/contract
High opportunity cost of market engagement	Low opportunity cost of market engagement	High opportunity cost of market engagement	Low opportunity cost of market engagement

LOW energy use / LOW cost (relative)			
High satisfaction with current supplier/contract	High satisfaction with current supplier/contract	Low satisfaction with current supplier/contract	Low satisfaction with current supplier/contract
High opportunity cost of market engagement	Low opportunity cost of market engagement	High opportunity cost of market engagement	Low opportunity cost of market engagement

Question 6: Do you have evidence demonstrating the extent and impact of malpractice by brokers dealing with microbusinesses? We are seeking both qualitative and quantitative evidence demonstrating consumer harm in the form of both financial and non-financial detriment.

Figure 5 shows that as many microbusinesses access the energy market via a TPI (including a broker, price comparison website or friend) as those that negotiate with energy suppliers directly.

Currently, TPIs can play an important role in helping businesses secure the best possible energy deals. However, as the energy landscape changes, the value for money that small businesses associate with their own personal energy deals will increasingly depend on the wider opportunities that come with them. The role of a TPI will become even more important as energy bills increasingly include costs associated with additional products and services, such as energy efficiency advice, renewable-sourced energy and smart technology.

Figure 5: How microbusinesses identified and agreed their last energy deal
Source: FSB energy market survey, 2019

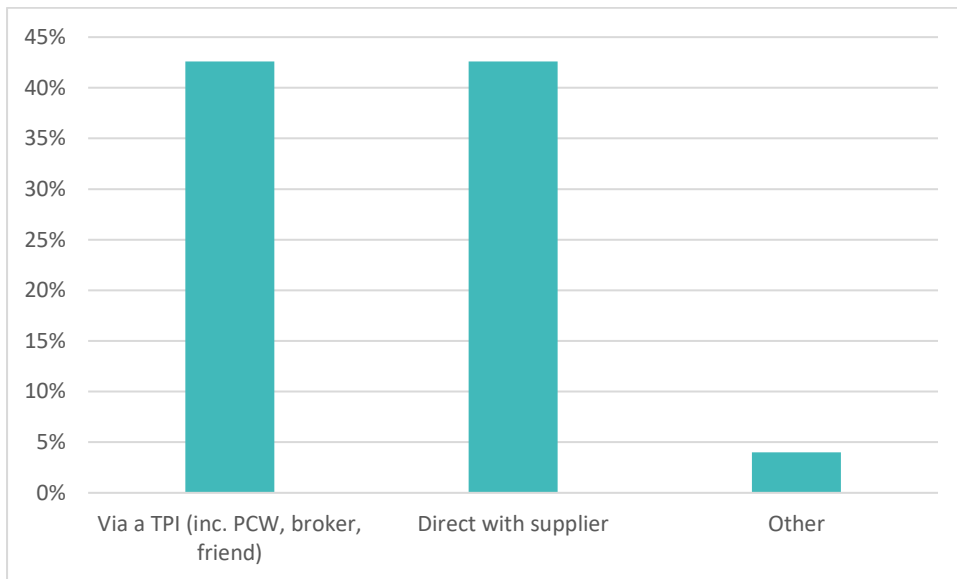


Figure 6 shows microbusinesses tend to believe that TPIs are more likely to work in their customers' interest compared to suppliers. However, it is a sobering fact that **only 39% of those that negotiated their last deal via a TPI, and just 16% of those that negotiated directly with a supplier, believe that their own interests were being prioritised.**

Figure 6: Microbusiness view of who the market is mainly working for – those that negotiated via TPI versus those that negotiated directly with suppliers
Source: FSB energy market survey, 2019

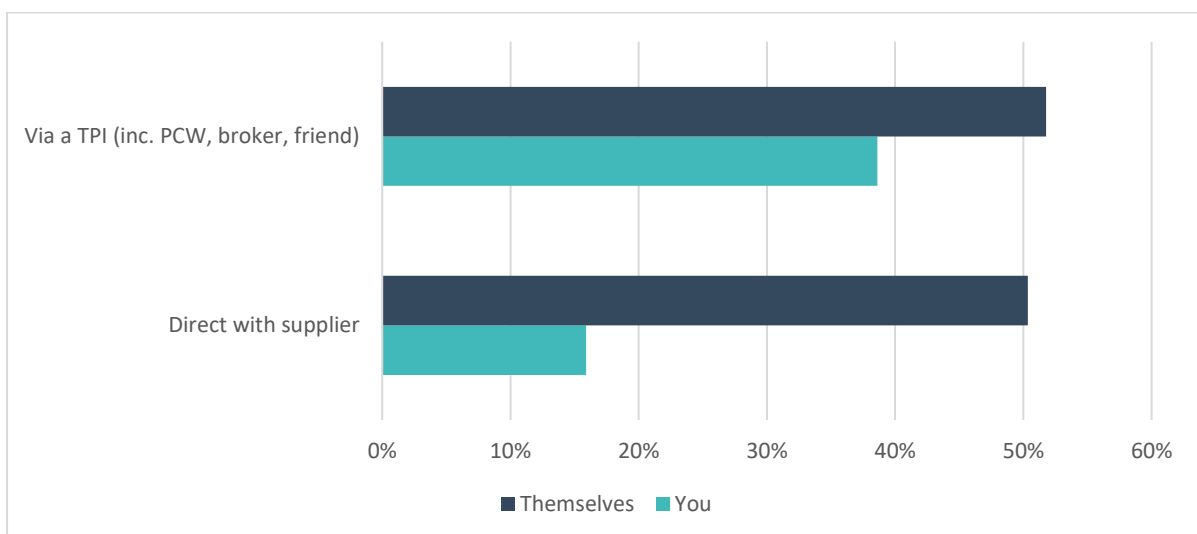
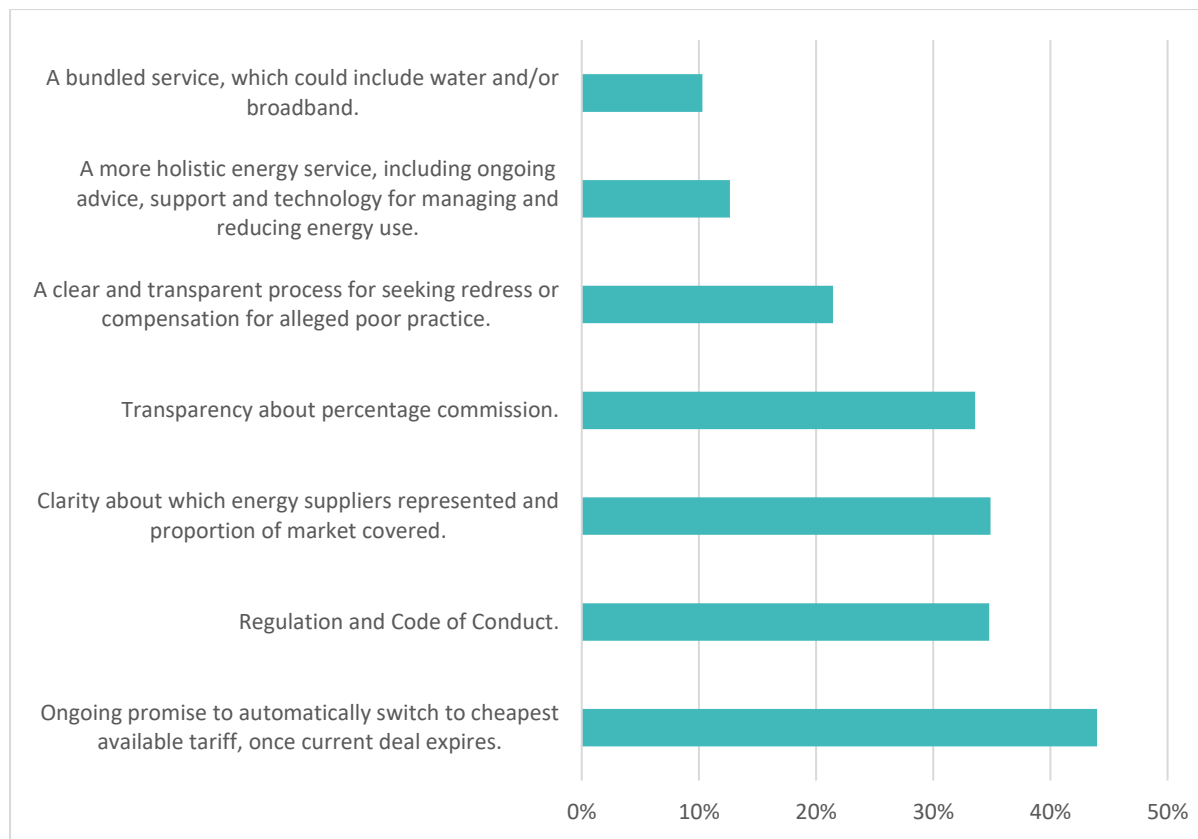


Figure 7: Microbusiness view of what would make them more likely to use an energy broker in future

Source: FSB energy market survey, 2019



Regulation

Figure 7 shows that many microbusinesses would be more likely to use an energy broker in future if:

- **They were licenced by the regulator to ensure they followed a Code of Conduct (35%),**
- **They were clear about which energy suppliers they represent and the proportion of the whole market they cover (35%),**
- **They were transparent about their percentage commission (34%).**

FSB supports the introduction of a regulated TPI industry, one which builds trust by promoting the good and excluding the bad. Before the CMA investigation into the energy market, FSB supported in the development of a draft code of practice for non-domestic TPIs, setting out customer engagement standards (professional and honest behaviour, transparency of information and effective monitoring).

The CMA formally acknowledged the problems associated with unregulated TPIs:

*"TPIs have the potential to help customers engage with energy markets and reach good outcomes. However, this may be undermined if customers do not trust TPIs. Our evidence suggests that there have been long-standing concerns about the conduct of a minority of TPIs; that some TPIs may not offer customers the best tariffs for the customer; and that customers lack information about how they pay for TPIs' services. These issues may not apply to all TPIs, but they may affect customer perception of all TPIs. This may deter the use of TPIs and form a barrier to higher levels of engagement."*⁴

Despite failing to address the TPI regulation issue directly, the CMA did acknowledge the work that Ofgem had begun in 2013 to explore a workable regulatory framework, essentially pushing this problem back to the regulator to deal with:⁵

*"Due to concerns about poor customer experience of using TPIs and the potential negative impact on future engagement that this may have, has developed a draft code of practice for non-domestic TPIs.⁶ The purpose is to build consumer trust and confidence when using TPIs. The draft code of practice sets out standards for TPIs when dealing with customers, such as: including clearer information, fair marketing tactics and effective monitoring and complaints redress."*⁷

Automatic switching & open data

Figure 7 also shows that **44% of microbusinesses say they would be more likely to use an energy broker in future if they made an ongoing promise to automatically switch customers to their cheapest available tariff, once their current deal expired.**

In the short term, FSB wants to see increased scrutiny around the system for giving consent for trusted TPIs to operate on behalf of their clients, specifically Letters of Authority (LOAs). Good TPIs have a valuable role to play in the energy market, yet there is evidence that LOAs received by some suppliers are not being dealt with adequately, leading to unnecessary delays for potential switchers. This is a key barrier to engagement. If businesses cannot get access to information about their contract and consumption, it leaves them in a poor position to exploit their own data and make informed choices around their energy use.

Recent research carried out by Make It Cheaper looked into the reasons why so many SMEs are disengaged from the energy buying process and tested the hypothesis that more would switch if there was a service to which they could delegate their authority and which adheres to their preferences.

⁴ CMA, Energy Market Investigation Final Report, Appendix 16.1: Microbusinesses (2016)

⁵ Ofgem website, Third Party Intermediaries (TPI) Programme working group, accessible at www.ofgem.gov.uk/gas/retail-market/forums-seminars-and-working-groups/third-party-intermediaries-tpi-programme-working-group

⁶ Ofgem, (Draft) Code of Practice for Non-domestic Third Party Intermediaries (2013)

⁷ CMA, Energy Market Investigation Final Report, Appendix 16.1: Microbusinesses (2016)

Make It Cheaper conducted research in November 2016 among small business owners, including FSB members. Qualitative and quantitative data gathered from an online survey of 300 businesses and two focus groups, found the following:⁸

- SMEs are less likely to tackle business energy costs than many other overheads, such as insurance, telecoms, rent and even their own household utilities.
- Among regular switchers, having someone they trust to take care of it for them is the number one driver for engagement in the market.
- An overwhelming majority (92%) expect their supplier to provide switching information to a third party operating on their behalf via a Letter of Authority (LOA).

Longer term, FSB wants to see open data fulfil its huge potential in the energy market. FSB recently published a report into the concept of 'Open Energy'.⁹ The solution proposed in that report is to give energy customers more control over their smart meter data and easier access to tariffs available on the market. This can be achieved by:

- a. Standardising tariffs and other relevant market information in machine-readable formats to allow automated comparisons of energy tariff offerings.
- b. Making smart meter data available through a secure standardised API to approved third parties.
- c. Allowing energy customers to delegate contract switching powers to third party intermediaries.

These reforms would increase switching rates and create opportunities for innovative uses of data, including for energy efficiency and demand-management purposes.

This model supports the "Access, Assess, Act" that is used by the CMA and Ofgem to model the customer choice process – businesses and domestic customers need to be able to access the possible offers available to them in the market; they need to be able to assess what tariffs and pricing offers are best for them using their own characteristics; and they need to be able to act to make a transaction, or nominate someone else to act on their behalf.

The short-term outcome of this would be an energy market that was more responsive to price signals of efficiency, and in which domestic customers could get the best deal much more easily. The long-term outcome would be a market that unbundled many of the roles currently performed by suppliers and allowed for greater specialisation in specific types of energy service, such as demand-side response, while lowering the barriers to entry for newer service providers.

As well as improving the functioning of the energy market for consumers, these reforms would improve demand-response by making adaptation to time-of-use electricity pricing easier – through smart home technology that can shift usage to off-peak times, for instance – which would overcome the problem of intermittency that faces many

⁸ Make It Cheaper, Switching On Small Businesses (2016)

⁹ FSB, Open Energy, 2018 – available at: www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-open-energy-report-final.pdf?sfvrsn=0

renewables. This would help solve the problem that the shift towards low-carbon generation will otherwise face, and deliver significant environmental benefits.

There has never been a better time for Open Energy. The implementation of Open Banking in the UK has led to the Australian government adopting the UK model and also looking at similar reforms in energy and telecoms. Political discontent at the dysfunctions present in the energy market has never been higher. The technology needed to provide rich individual customer data is now becoming available. And across other markets, old players are being displaced by newer, more innovative rivals that use data effectively to lower costs.

Opening up data in other markets has helped to make them easier to navigate and simpler for customers overall. Transport for London's open APIs for London Bus and Underground schedules and routes have freed people from manually navigating the tube and bus maps, let alone having to remember how frequent a service is at a certain time of day. Now, they just enter a destination into apps like Citymapper, and let the app do the work. It is simple and effective, and it reduces the cognitive load on users instead of increasing it. Energy should be no different.

I trust this helps to adequately clarify FSB's position. If you would like any further information or input from FSB, please contact our Deputy Head of Policy, Andrew Poole, at andrew.poole@fsb.org.uk.

Yours faithfully,

A handwritten signature in black ink that reads "Allen R. Creedy". The signature is written in a cursive style with a large, sweeping loop at the end.

Allen Creedy MRTPI FIEMA
Environment and Infrastructure Policy Chair
Federation of Small Businesses