

Residential retail review

20 July 2016

ofwat

Residential retail review
Welcome
Jonson Cox, Chairman

Residential retail review
Emerging findings
Cathryn Ross, Chief Executive

Purpose of today: to discuss on our emerging findings and to seek further evidence and information on our assumptions to support the final review.

1.35 pm	Introduction	Cathryn Ross, Chief Executive, Ofwat
1.45 pm	Our approach	Giles Stevens, Director, Ofwat
2.05 pm	Cost benefit analysis	Ben Smithers, Interim Principal, Ofwat
2.15 pm	Clarification Q&A – Chaired by Cathryn Ross	
2.30 pm	Break	
2.50 pm	From the customer perspective	Deryck Hall, Head of Policy & Research, CCWater
2:55 pm		Zoe McLeod, Sustainability First and Water 2020 advisory panel independent member
3.10 pm	Table discussions on emerging findings	Introduced by Iain McGuffog, Director, Ofwat
4.00 pm	Feedback – Chaired by Iain McGuffog, Director, Ofwat	
4.25 pm	Wrap up and close	Cathryn Ross, Chief Executive, Ofwat
4.30 pm	Close	

Government outlined clear intent in “A Better Deal: boosting competition to bring down bills for families and firms”

“The government is driving water market competition. Business and other non-household customers will be able to switch suppliers from 2017. **Ofwat will provide an assessment by summer 2016 of the costs and benefits of extending retail competition to household water customers.** Following this, the government will work with water companies to begin the transition to household retail competition before the end of this Parliament.” Pg. 7, “A better deal”, HM Treasury, November 2015

“Building on opening up the non-household retail market to competition, **the government wants to extend choice to households.**” Pg. 11, “A better deal”, HM Treasury, November 2015

A reminder of our three **key principles** for the review

1. The decision on whether, in what form and on what timeline the household retail market in England will be opened to competition is a matter for the UK Government.

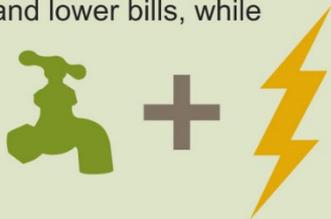
2. Our assessment of the costs and benefits of extending retail competition to households will be evidence based. The evidence we consider will be drawn from a broad base.

3. We will follow an open and transparent process, seeking evidence and ideas from those in the sector and beyond.

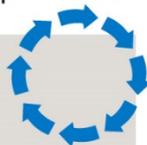
There are **potential benefits** available from the introduction of competition. The scale of those benefits will depend on how competition is designed and implemented.



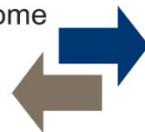
Half of the customers we surveyed would be interested in switching and just under half would switch for the **offer of additional services**, even if there was no price saving. For example, for the convenience of a single utility bill including energy and water, or water efficiency services to help reduce consumption and lower bills, while helping to improve resilience.



In modelling costs and benefits we took account of the **experience in energy markets**, as well as business learnings and technology which were not available at the time of opening the energy market. We have also been informed by the ongoing process to open to competition the business market for water and wastewater retail in England.



Choice is something customers want – our research suggests that more than half of customers would welcome having a choice as a result of competition.



Savings are more likely to be achieved if **multi-utility retailers** enter the market, as they could spread fixed costs over a larger number of customers and pass on the savings. Competition could also spur improvement in the management of bad debt.

The use of **new technologies** could make switching easier for customers and cheaper for retailers, promote water efficiency and better wastewater management, and help to improve resilience.



Many customers say they would want **significant savings to switch**.

Retail costs account for about 10% of the average bill of £386. Our analysis shows that competition could drive efficiencies in retailing that on their own would suggest a price saving for customers in the order of £6 – or 2% – off the average bill. This is in addition to the benefits that come from effective regulation.



We have also identified the **potential costs** for water companies, retailers, and those operating and overseeing the market, such as regulators. Under one scenario we have modelled, these costs could outweigh the benefits.



There are important **policy decisions** that would need to be given careful consideration ahead of introducing a competitive market. For example, whether and how to provide protection for customers who are not active in the market, how to provide assistance for vulnerable customers and social tariffs.

Residential retail review
Emerging findings
Giles Stevens, Director

We have drawn on a wide range of sources for the assessment, both within this sector and elsewhere, and have qualitatively and quantitatively assessed a wide range of potential costs and benefits of residential retail competition under a number of different scenarios

Well evidenced review to inform Government and to ensure that the policy decision it takes delivers benefits for customers.

Customer research

Qualitative analysis

Quantitative cost benefit analysis

Customer research:

We commissioned Accent to obtain genuine insights on customer preferences and concerns

We have used this to inform our considerations of the competition models and cost benefit analysis to inform Government and ensure any policy decision it takes delivers benefits for customers

We have also considered CCW research that explores customers' expectations of savings in a competitive market

Qualitative analysis:

Identified variety of models of competition which could be considered for the residential retail market

Considered benefits and unintended consequences of introducing competition to inform the development of the competition models

Identified a range of policy issues which would need to be considered in the design of any model of competition including how the risks could be mitigated and opportunities realised

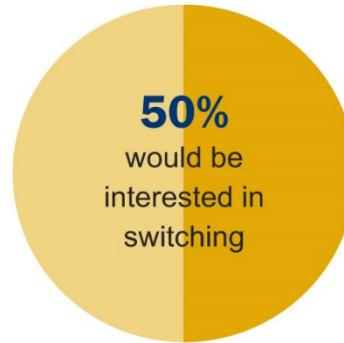
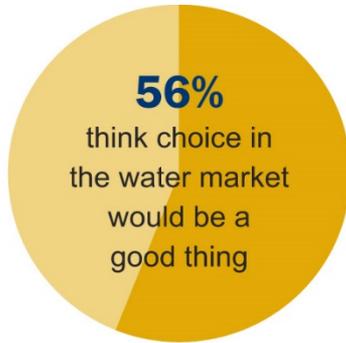
Quantitative estimates:

Constructing a 'do nothing' counterfactual

Estimating the potential impacts of competition on the counterfactual

Estimating costs to all parties of setting up and maintaining new arrangements

Comparing costs and benefits over time to estimate the 'present' value of each



Older customers were least enthusiastic about switching and were concerned about the burden of choice and confusion about who to contact in an emergency

Customers struggling or in debt were more positive about the idea of choice than average



Main reasons customers think choice is a bad idea **X**

- Prices will go up.
- More complicated; administrative problems.
- Do not see the point.

Main reasons customers are neutral about choice **=**

- Happy with current service.
- Do not think choice will make a difference.
- Not sure of benefits.

Main reasons for customers to support choice **✓**

- Competition is a good thing.
- Cheaper bills.
- More choice, can shop around.
- Better service.

We have qualitatively assessed certain areas, including the value of:

- choice;
- customer service;
- convenience (such as multi-utility billing); and
- new innovative technology

We asked the following.

- Can any of these areas be meaningfully quantified?
- What additional sources of evidence should we consider?

There is a need for a strong and effective regulator.

New entrants need to be actively engaged and the regulator must ensure they are not disadvantaged in any way.

Energy markets benefited from phased opening to learn lessons as the market progressed.

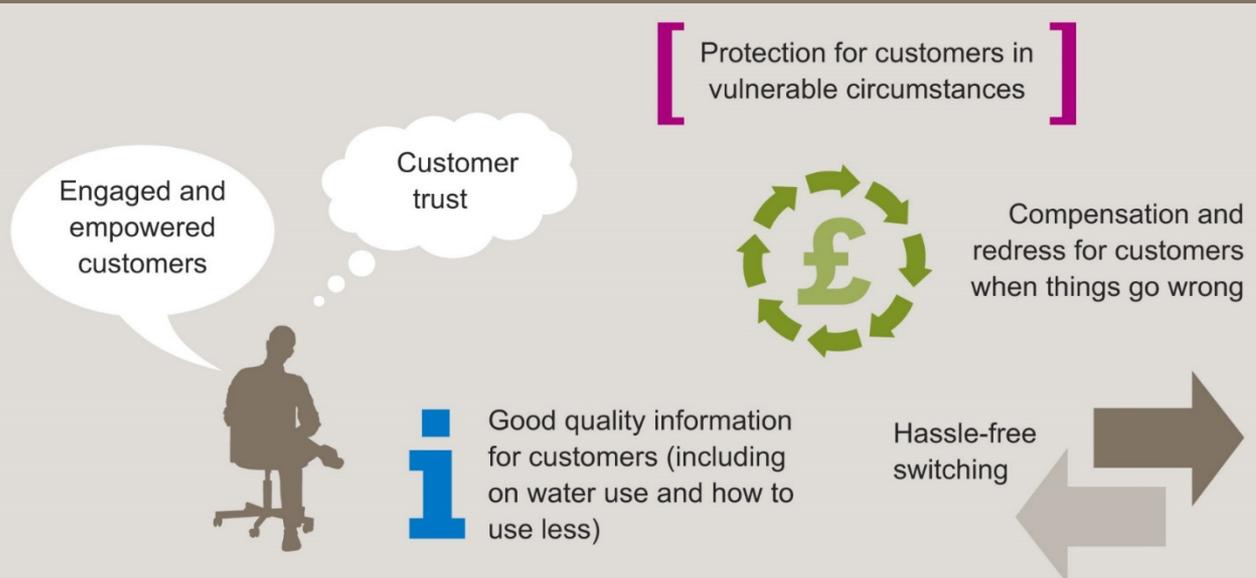
Consider ways to ensure the benefits of competition reach as many customers as possible.

Consider the needs of potentially vulnerable customers ahead of market opening.

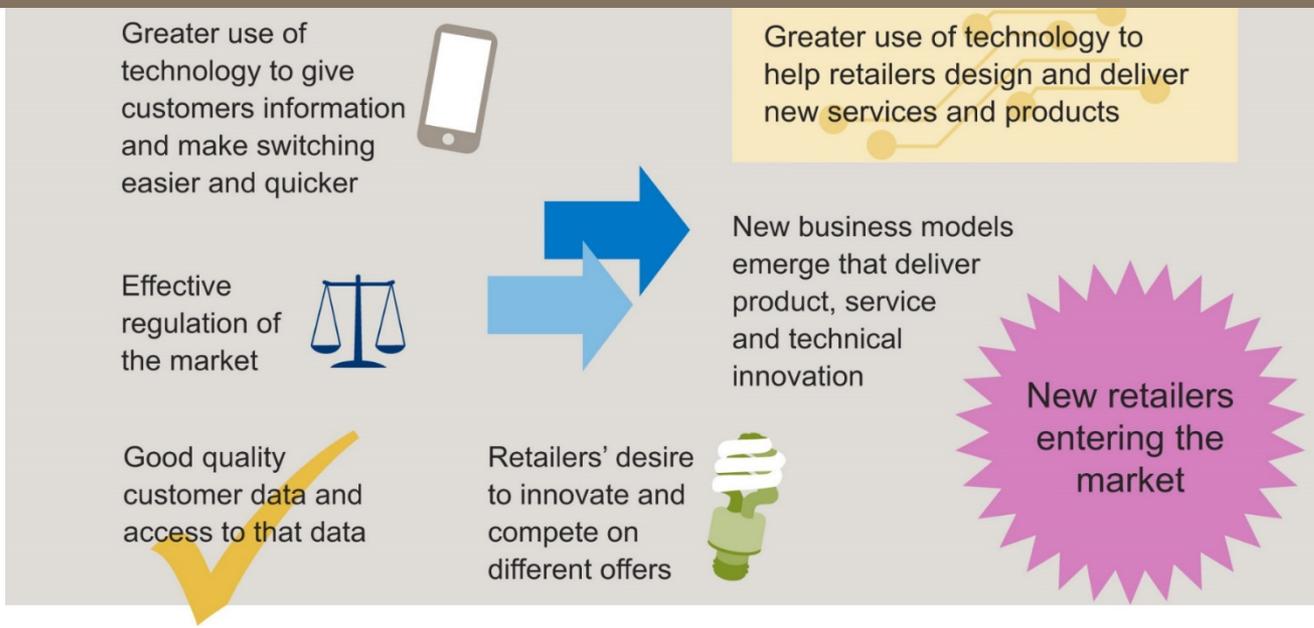
Customer engagement is central to the success of a competitive market.

Facilitating entry from established players in other markets, such as gas and electricity, will be important to stimulate competition.

Drivers for success



Enablers of success



Scenario 1 – lower cost, widespread innovation, strong competitive activity

£6

Average saving per customer per year

£2.3 billion

Total net benefit

Scenario 2 – lower cost, some innovation and good competitive activity

£4

Average saving per customer per year

£1.2 billion

Total net benefit

Scenario 3 – higher costs, some innovation and good competitive activity

£2

Average saving per customer per year

£655 million

Total net benefit

Scenario 4 – higher costs, little innovation and weak competitive activity

£1

Average additional cost per customer per year

-£640 million

Total net cost

Residential retail review
Cost Benefit Analysis
Ben Smithers, Interim Principal

Quantitative modelling:

1. Start with what we know now about future developments (the counterfactual)
2. Estimating the potential impacts of competition on the counterfactual
3. Estimating costs to all parties of setting up and running competition
4. Comparing costs and benefits over time to estimate the 'present' value of each

What it is:

based on modelling the residential water & wastewater value chain
assessment of aggregate impacts

Explores **potential outcomes** through scenarios

What it is not:

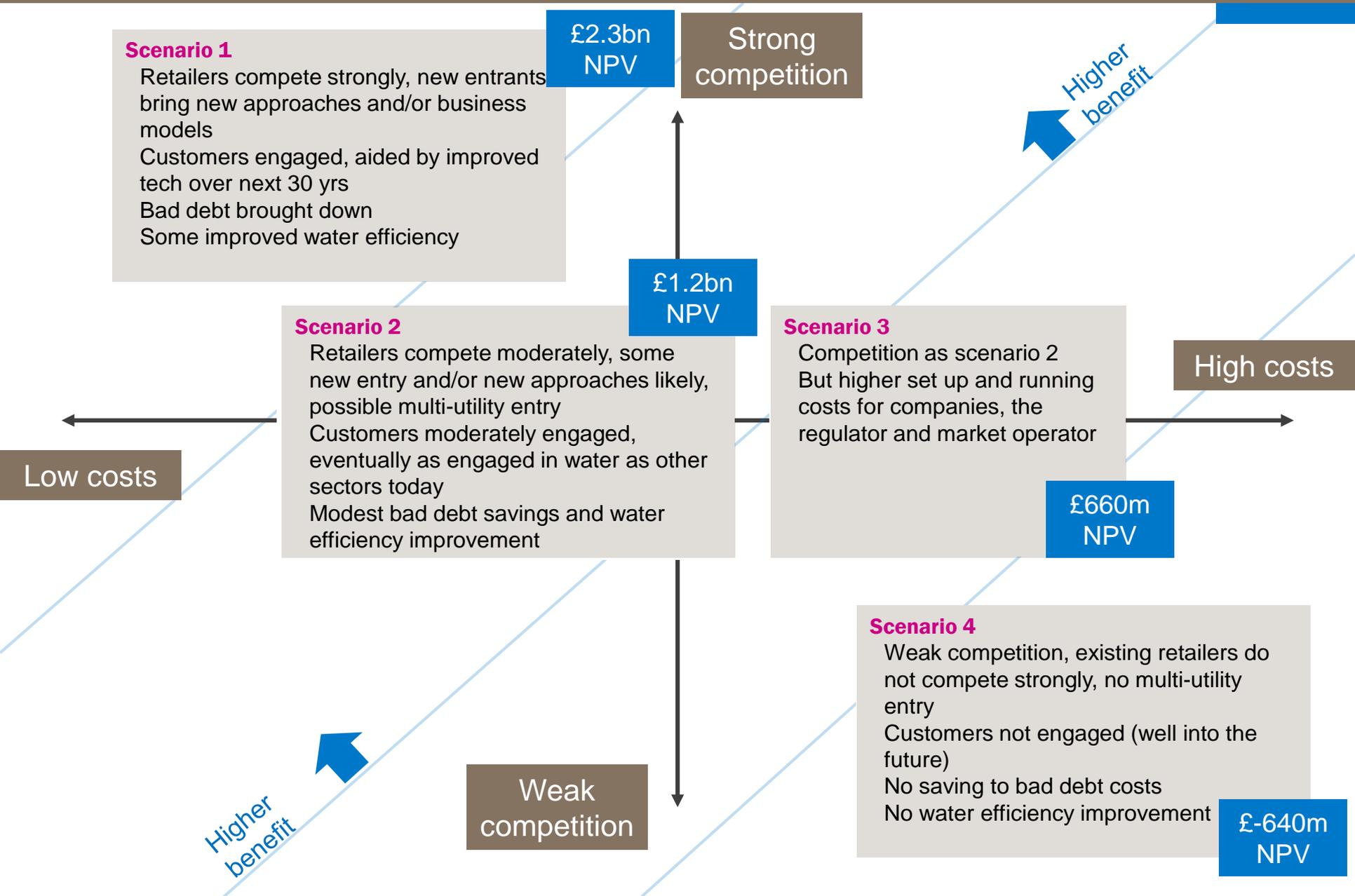
A forecast, nor assessing effect of specific market design / policies

An estimation of the bill impact (aggregate vs. individual behaviour & outcomes)

Modelling the competitive process / individual company positions

A quantitative assessment of all the impacts

Emerging cost-benefit findings: Scenarios – what you need to consider



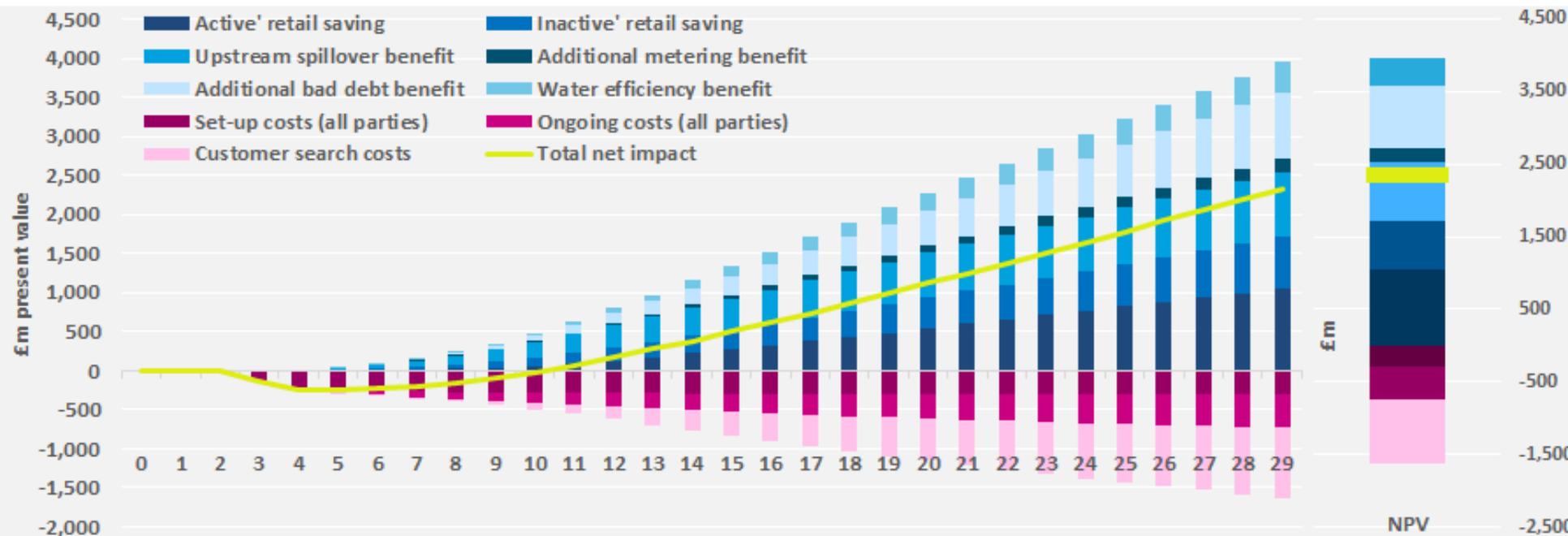
Emerging cost-benefit findings

Results

Present value terms

Cumulative effect over time,
in present value terms

£m NPV)	Sc. 1	Sc. 2	Sc. 3	Sc. 4
'Active' retail saving	1,053	551	551	140
'Inactive' retail saving	669	871	871	561
Wholesale benefit	811	496	496	228
Additional metering benefit	177	0	0	0
Additional bad debt benefit	856	455	455	0
Water efficiency benefit	389	98	98	0
Set-up costs (all parties)	-294	-326	-559	-564
Ongoing op. costs (all parties)	-441	-474	-801	-794
Switching cost (customers & co.s)	-893	-455	-455	-209
Total net impact	2,327	1,215	655	-639



Evidence

Best available for the residential retail water market

But some key areas where more information would better inform a decision either because i) the evidence base is not as strong as we would wish or ii) they have a large impact on results.

Evidence particularly welcome on potential impact of residential water and wastewater competition on:

Residential-specific set-up and ongoing costs (particularly for companies)

Bad debt in the water sector

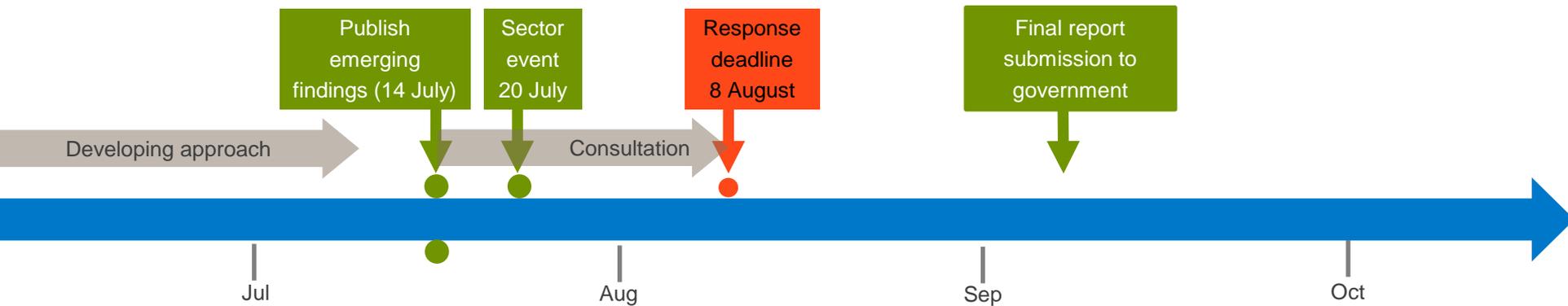
Water efficiency, wastewater efficiency...

... and the impact / value of resilience

Potential impact on quality of service

and any other areas of the analysis

Clarification questions?



We will submit our final report to HM Treasury in September which will set out:

- the overall potential costs and benefits that may be incurred as a result of any potential introduction of competition using a range of assumptions of how the future market for household retail competition in England could evolve;
- specific issues that could affect the feasibility of implementing certain competition models; and
- the options that are evident under various different scenarios of the way that the future water sector in England may evolve.

Break

The customer perspective
Deryck Hall, Head of Policy & Research
Consumer Council Water

Residential Retail Review – a consumer perspective

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Zoe McLeod
zoe.mcleod@gmail.com
20th July 2016

Focus on outcomes

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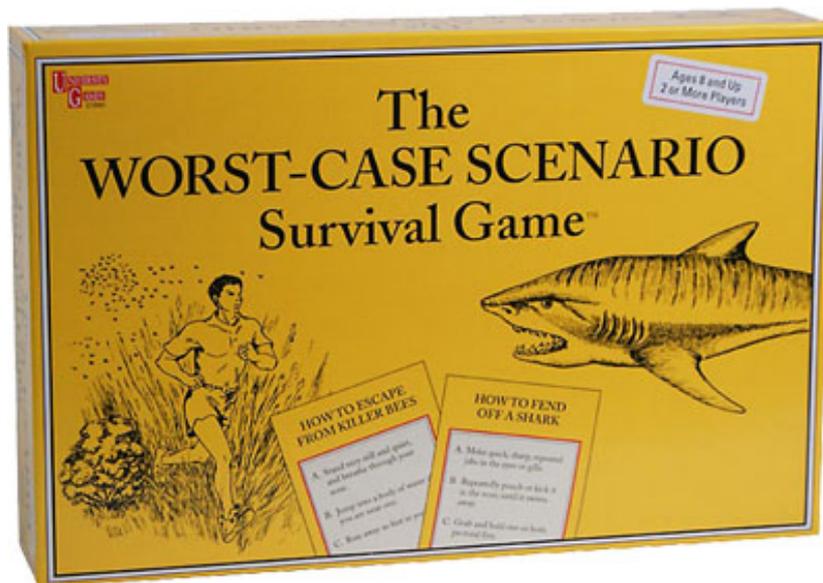


- Consumer & public interest outcomes
- Current & future concerns
- Competition & choice not ends in themselves

Customer service declines/complaints rocket

e.g. issues with new entrants. New complaints around switching, mis-selling, rollover contracts. Harder to get resolution & redress when things go wrong.

Prices rise e.g. lack of switching, barriers to entry, savings not realised by retailers or cost savings not passed on.



Trust declines Less

– spiral of lack of confidence impacts customer engagement, investors, costs.

control/understanding e.g. with bundling, single bills

Undermines collaboration

on water resource management, water efficiency, longer-term considerations.

Add to 'poverty premium' /increased inequality

e.g. poor terms for debt-risk customers, payment differentials, unraveling of cross subsidies, regional variations increase.

Retail innovation fails to deliver

e.g. gadgets cost more than save, customers locked-in, increased complaints, insufficient incentives for retailers do water efficiency

Choice declines for some e.g. online offers only, profiling restricts tariff choices



- What lessons can be learnt from other sectors?

4 areas for consideration:

Processes & infrastructure

Impact on different customer segments

Protections & enablers

Engagement



1. Processes & infrastructure

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Don't underestimate the challenge in terms of:
resources, complexity & collaboration

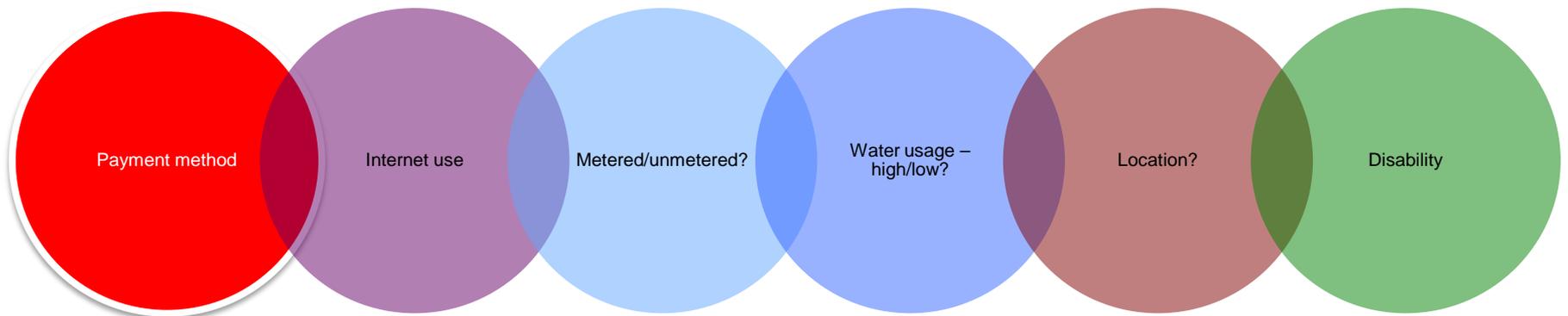
e.g.

- Switching processes
- Data flows, privacy & access
- Standards & interoperability
- Regulatory framework – rights & responsibilities with merging markets
- Changes to internal company processes

2. Distributional impacts

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- No such thing as an average consumer
- **Need distributional impact assessment**
- Systematically map customer characteristics & circumstances against common market activities
- Identify any potential issues & take action as needed
e.g.



Low income/debt-risk customers

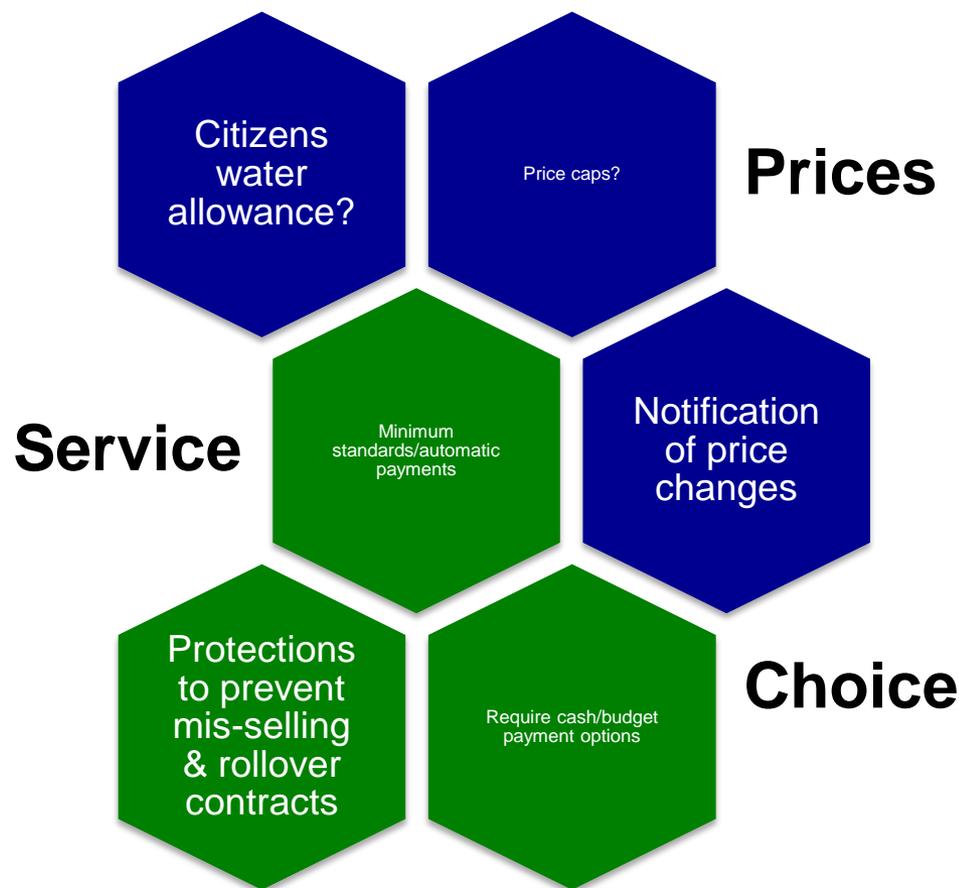
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3. Protections & facilitators

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- New protections will be needed
- Existing safeguards future-proofed/reviewed
- Map & aim to fix existing problems
- Support piloting – phased approach



DON'T WAIT AND SEE

- Pre-emptive approach
 - Get it right first time
- Trust hard to build, easy to lose
 - Important to monitor
- Support for new entrants to help with compliance.

4. Engagement

1. Trust is essential for engagement
2. Information alone is not enough
3. Measures which encourage, enable, exemplify and engage consumers.
4. Enable use of technology, data, automation
5. There will always be some consumers who need additional support.

Encourage e.g.

- Company marketing
- Campaigns
- Cross sector initiatives
- Social pressure

Enable e.g.

- TPIs
- Free-phone numbers
- Tariff comparability
- Access to portable consumption data

Exemplify e.g.

- Government behaviour
- Consistent policies
- Exemplar homes
- Show case best practice

Engage e.g.

- Community action
- Social networks
- Workplace activities
- Schools activities

Conclusion

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- Focus on understanding & delivering improved customer/public interest outcomes
- Government shouldn't underestimate the challenge & resource needed to make it work for all
- *If* go ahead, must have high expectations about what will be delivered - learn lessons from other sectors but also need new thinking for a world of evolving technology & merging markets.

Discussion session
Chaired by Iain McGuffog

Tables 1 + 6

- If the residential retail market is opened to competition, what would it deliver for customers? How can we ensure that vulnerable customers are protected?
- What could we add to our analysis? What do we need to take into account before our final submission in September?

Tables 2 + 7

- If the residential retail market is opened to competition, what would be the role of innovation and technology in the development of the market?
- What analysis could stakeholders provide to support our work?

Tables 3 + 8

- If the residential retail market is opened to competition, what can be learned from experiences in other sectors?
- What could we add to our analysis? What do we need to take into account before our final submission in September?

Tables 4 + 9

- If the residential retail market is opened to competition, what implications could there be for the environment?
- What analysis could stakeholders provide to support our work?

Tables 5 + 10

- If the residential retail market is opened to competition, what kind of new services and new entrants might be interested? What might be the investor perspective of the market?
- What could we add to our analysis? What do we need to take into account before our final submission in September?

Next steps

**Closing dates for responses to our
emerging findings is 8 August**

Household.Review@ofwat.gsi.gov.uk

Thank you!

Close