State of the market 2018–19: reviewing the second year of the business retail water market
About this document

This document sets out our assessment of the state of the business retail market in its second year of operation (April 2018 to March 2019). It is our second annual review, and updates our assessment of the first year of the market that we published in July 2018 (Open for business).
Contents

Executive summary

1. Introduction 5
2. Customer outcomes 9
3. Market functioning 30
4. Conclusions and next steps 43

Annex A1 Market developments 44
Annex A2 Market performance framework 55
Annex A3 Regulatory developments in customer protections 60
Executive summary

Following the opening of the business retail water market in England in April 2017, around 1.2 million business customers have been able to choose their water services retailer. This is our second annual review of the business retail market, which covers the period 1 April 2018 to 31 March 2019 and updates and builds on our first report – Open for business.

While the market continues to develop and deliver some further benefits for customers, overall we are disappointed in the slow growth of such benefits and slow progress in resolving the market frictions that were set out in our report last year. Key findings for the second year of the market (2018/19) include:

- **Just over half (53%) of all customers are aware** of the possibility to choose their retailer (48% last year).
- Customer activity has been broadly steady. Around **13% of customers have been active since market opening**, in that they have switched, renegotiated or considered doing so (10% last year). **Switching rates 3% largely unchanged** in the second year of the market.
- We estimate that customers saved **around £10 million in bills** in the second year of the market, with benefits mainly accruing to larger and higher consumption customers. This compares to a saving of £8m last year.
- The **offer and take up of water efficiency measures has been slow to develop**. Around 0.3% of customers who switched since market opening report leakage control services as a benefit of switching. Around 4% of customers who had renegotiated since market opening report water efficiency services as a benefit of renegotiating. On the basis of data provided by self-suppliers, estimated volume savings achieved between 3 self-suppliers from moving to self-supply were around 150 Ml in 2018.
- **Some customers are consolidating bills** - around 8% of customers who had switched and 9% of customers who had renegotiated since market opening said benefits of switching included some form of bill consolidation. Larger customers are more likely to consolidate bills – for example 21% of large customers who switched said a benefit of switching was bill consolidation across multiple premises.
- Customers appear to be primarily motivated to engage in the market by the prospect of financial (bill) savings. **Smaller customers are more likely to perceive that benefits of switching are unlikely to exceed the costs.**
- The **majority of customers are satisfied** with their water services retailer (80% reporting either ‘very’ or ‘fairly’ satisfied). But around 5% (equating to around 60,000 business customers) report being ‘very dissatisfied’. Three fifths (60%) of dissatisfied customers cite billing issues, such as not receiving bills or receiving incorrect charges, as a reason for dissatisfaction.
• **Complaint levels remain much higher than before market opening** - Complaints to the Consumer Council for Water ("CCWater") have quadrupled since market opening. The majority of these complaints (70% in 2018–19) concern billing and charges, which in part reflect deficiencies in market data such as timely and accurate meter readings. Written complaints received by retailers about the business retail market have also increased since market opening, increasing by 20% over the year 2017/18 to 2018/19.

Last year’s report identified three main market frictions that were: raising costs for retailers and brokers; impeding the development of an effective market; and undermining the market’s potential to deliver improved outcomes for customers. The main frictions identified were:

- **Wholesaler performance**: Poor aggregate performance of wholesalers in meeting industry requirements increases retailer costs (though we note some individual wholesalers performed well).
- **Data quality**: A lack of complete, accurate and timely market data - particularly meter reads – impedes parties’ ability to trade effectively. Poor data leads to inaccurate or disputed billing and can undermine water efficiency measures.
- **Wholesaler – retailer interactions**: Ineffective communication between retailers and wholesalers results in a poorer customer experience and reduces customer confidence in the market.

Despite some action from the sector to address these market frictions in year 2, **significant problems remain**. For example, concerning poor data quality, the proportion of meters with reads more than a year old increased from 12.5% in March 2018 to 14.4% a year later.

**On the basis of evidence set out in this report it is clear that significant and urgent action is required by the sector to resolve market frictions and deliver improved outcomes for customers.**

We are starting to see some market participants step up – for example we support the market operator’s (MOSL) focus on improving: customer outcomes; and trading party performance and accountability in its *operating plan* for this year, including its programme of work to achieve this. But **resolving market frictions will require all market participants to step up and work collaboratively.**

Ofwat’s Chief Executive has recently written an *open letter* to wholesalers noting that their overall level of support for the development of effective markets is unacceptable. This letter indicated that we expect to see a significant improvement in the coming months and will review progress in autumn 2019. The letter also notes that retailers have a role to play and in some cases should be taking further action. Ofwat is committed to working with the sector to make the business retail market work better for customers. The letter notes that we will review wholesaler progress in the autumn and at that point consider what further steps may be required.
1. Introduction

1.1 Second year of the market

Following the opening of the business retail water market to competition in April 2017, more than 1.2 million business customers in England and Wales\(^1\) have been able to choose their retailer for two years now. We set out our assessment of the first year of the market (April 2017 – March 2018) in our July 2018 report Open for business.

This report assesses developments in the market in its second year of operation (April 2018 – March 2019). This includes an assessment of: customer outcomes delivered by the market; and how effectively the market is operating for customers. The latter includes a particular focus on progress made to resolve market frictions i.e. the issues that prevent the market from functioning effectively and delivering improved outcomes for customers.

1.2 Vision

As we set out in Open for business, our vision for the market remains a vibrant business retail market that delivers good outcomes for customers, saving them money, water and time. As set out in our draft strategy, we propose to retain and evolve our use of markets – working closely with relevant stakeholders to ensure markets work better for customers and society.

We continue to expect that a well-functioning and competitive business retail market, supported by targeted and effective regulation, should enable customers to save money, water and time in one or more of the following ways:

- **money** – competition can lower customer bills as retailers compete with one another to win and retain customers, including through development of new or enhanced business models;
- **water** – customer choice and increased rivalry between retailers should incentivise retailers to innovate and develop enhanced water efficiency services, and to offer customers choices for these, enabling customers to reduce leaks, water consumption and therefore bills;

\(^1\) In England, most businesses taking clean or waste water services are eligible to choose their water services retailer. However businesses based from home or from a business managed premises are not eligible. In Wales, a business customer is eligible where their annual consumption exceeds 50 Mega litres.
• **time** – customers may save time spent on administrative tasks where retailers compete to offer improved services such as consolidated billing, account management or better metering services.

We would also expect to see benefits extend beyond the business retail market. For example:

- Better customer outcomes in terms of more efficient water consumption can contribute to **wider environmental benefits** as pressures on water abstraction and infrastructure development are reduced;
- A well-functioning business retail market should facilitate and deliver **more innovation**, which filters into the broader industry. Competition between water services retailers as well as other providers could encourage new business practices or services which aim to win business by meeting customer needs and expectations more effectively; and
- Competition in the business retail market can generate customer benefits beyond those delivered to business customers. For example, improved efficiencies or customer service generated in the business retail market could be adopted when serving household customers. Furthermore, competition at the retail level can facilitate or drive learning and efficiencies for wholesalers, as retailers identify and communicate their needs and wholesalers react to such needs.

The market will only be able to deliver to its full potential and result in improved customer outcomes where customers are informed (about their ability to switch and about the offerings of different retailers), see prospective benefits in new offers or deals, and are able to switch quickly, easily and without hassle. From a supplier perspective, efficient market functioning should be characterised by the ability of retailers and other providers to enter and operate in the market without undue barriers or costs.

Furthermore, retailers and wholesalers should act in ways that support overall effective market functioning, in particular in ways that aim to meet customers’ interests and requirements. The market operator (‘MOSL’) also has a role to act to facilitate and support effective market functioning, including by supporting relevant amendments to market codes and encouraging and supporting trading parties to meet industry requirements. MOSL have also set out that their most recent **Market Performance Operating Plan 2019/20 (MPOP)** is guided by two primary objectives: to deliver improved customer outcomes; and to deliver improved trading party performance and accountability.
1.3 Approach to this year’s report

This report draws on a wide range of evidence to provide an objective assessment of the business retail market. The focus of this report is:

- the delivery of improved customer outcomes (benefits from saving money, water and/or time); and
- an assessment of how the market is operating - focusing on progress made to address the market frictions we identified in last year’s report, which need to be addressed for the market to operate more effectively and deliver improved outcomes for customers.

We have used a wide range of evidence and information to inform our assessment of the second year of the market, including:

- market data supplied to us by MOSL;
- information from retailers on their activity in the second year of the market;
- evidence and information gathered as part of Ofwat consultations and call for inputs such as our November 2018 Call for Inputs: Strengthening wholesaler performance and service in the business retail market;
- Customer Insight Survey (“CIS research”) jointly commissioned by Ofwat and the Consumer Council for Water (‘CCWater’) and undertaken on our behalf by Opinion Research Services (ORS) in March-June 2019. This CIS research explored customers’ experiences in the business retail market through two tranches of research:
  - Quantitative: ORS telephone survey of 2,000 eligible business customers; and
  - Qualitative: ORS in-depth telephone interviews with 73 business customers. We have published the results of this research alongside this report².
- data on complaints made to CCWater³;
- the views of customers and customer representative groups⁴; and
- reports and industry views – such as research conducted by CCWater into customer experiences, and reports on industry performance published by MOSL.

² Available at: Non-household Customer Insight Surveys Final Report July 2019; Non-household Customer Insight Qualitative Interviews Final Report July 2019; ORS data tables 2019 Representative survey of eligible business customers; ORS data tables 2019 Switchers Survey of eligible business customers who switched or renegotiated
³ See in particular: CC Water Non-household customer complaints to water retailers, water companies in Wales, and Consumer Council for Water 1 April 2018 - 31 March 2019
⁴ For example, in March 2019 Ofwat hosted a focus group for larger customers to share their experiences of the second year of the market. Ofwat also participates in a number of industry forums aimed at understanding the experiences and issues of business customers in the retail market.
1.4 Structure of this report

The remainder of this report is structured as follows:

- Review and assessment of customer outcomes delivered in the second year of the market (section 2);
- Assessment of how the market is functioning, focusing on the market frictions identified in last year’s report (section 3);
- Next steps (section 4);
- Annex A1 provides further analysis of relevant market developments;
- Annex A2 sets out charts of wholesaler and retailer performance under the Market Performance Framework; and
- Annex A3 provides summaries of our proposals for Retail Exit Code (‘REC’) price and non-price protections, published alongside this Report.
2. Customer outcomes

Summary

Overall, customer outcomes remain broadly unchanged in the second year of the market.

Levels of customer awareness have increased marginally. Our research suggests that more than half of all customers (53%) are now aware of the business retail market and the possibility to choose their retailer – up from 48% in the first year of the market, with awareness higher among larger customers (65%).

Customer engagement is broadly stable. Switching rates in the second year, broadly around 3%, remain similar to or slightly below those from last year. Annual switching rates for large customers remain higher than the market average (around 15% vs 3% (customer switching, CIS 2019) and around 9% vs 4% (supply points switched, MOSL)). The majority of switchers reported that they found the switching process to be either ‘very’ or ‘fairly’ easy (93%).

Renegotiation is an important option for some; around 2% of customers renegotiated a new deal with their existing provider (CIS 2019), compared to around 1-2% last year (CIS 2017 and retailer data). However data received from retailers implies that renegotiation is driving a smaller proportion of bill savings in year 2 compared to year 1.

As in the first year of the market, saving money on bills is the main reason for switching or renegotiating (e.g. 52% of switchers and 62% of renegotiators cited ‘lower bills’ as a reason to start looking into switching or renegotiating), with bill consolidation also a reason for those who had switched or renegotiated since market opening (around 13%).

We estimate that customers who have switched or renegotiated since market opening realised savings of around £10 million in the second year\(^5\), or £12 million on an annualised basis, compared to what they would have paid under default tariffs. This compares to our estimate of £8 million of realised savings in the first year of the market (£12 million annualised).

There are some signs of interest in value added services - around 5% of all customers, and around one in ten (12%) of large customers report that water efficiency, leakage control and enhanced metering services are important to them as a water customer. Take up of such services was higher among those who have renegotiated since market opening; 22% reported taking up such services. Though

\(^5\) Excludes financial savings due to any reductions in water consumption
among customers who had switched since market opening, reported take up of such services was only around 4%.

Around one in five (19%) customers who had switched since market opening reported that the time spent dealing with water bills had fallen since switching. However, just over one in ten (12%) customers who had switched since market opening reported that the time spent had increased.

Of those customers who are aware of the market but who have not switched or renegotiated, around half (47%) have chosen not to consider switching or renegotiating. Reasons cited by these customers for not considering switching or renegotiating suggest, in our view, that they currently perceive the costs of engaging in the market to outweigh the benefits. Nevertheless we note that around one third (34%) of aware customers (or around one fifth (18%) of all customers) report that they plan to consider switching or renegotiating in the future.

In-depth interviews with customers suggest significant lack of knowledge of the market, with many lacking knowledge about alternative providers, which may contribute to some customers’ reluctance to consider switching. Third Party Intermediaries and brokers help to fill the gap here, as a substantial proportion of customers look to these providers to find offers and organise switches – for example around one in three (34%) of customers who had switched, renegotiated or considered doing these said they had used a broker to search for information about alternative retailers.

The majority of customers (80%) report that they are either very or fairly satisfied with their retailer – similar to satisfaction levels in the first year (at 77%). Complaint levels have increased since market opening, and 2018/19 saw complaints received by CCWater from business customers increase by 43% compared to the year before (2,780 complaints in 2017/18, against 3,975 over 2018/19). Consistent with last year, the principal causes for dissatisfaction and complaints are billing and charging issues (70% of complaints in 2018/19). Written complaints received by retailers about the business retail market have also increased since market opening, increasing by 20% over the year 2017/18 to 2018/19.

### 2.1 Introduction

This section reviews and draws together evidence on customers’ experiences in the second year of the market and assesses the extent to which the market has delivered improved customer outcomes. This section is structured as follows:

- customer landscape – summary of the size and type of business customers;
- customer awareness and engagement;
• motivation to switch or renegotiate;
• searching and comparing;
• use of brokers and third party intermediaries;
• extent of switching and renegotiation;
• experiences of the switching process;
• customer outcomes – in terms of money, water and time saved; and
• satisfaction, dissatisfaction and complaints.

Evidence indicates that customer experiences as well as outcomes differ markedly depending on the type of customer in question. In this report we distinguish particularly between the following types of businesses:

• microbusinesses (businesses with fewer than 10 employees or annual consumption below 0.5 ML). Examples of these kinds of businesses include church, bank, pub, hairdresser, local garage.

• SMEs (businesses with between 10 and 249 employees or annual consumption between 0.5ML and 5ML). Example of these kinds of businesses include hotel, warehouse, farm, university, chemical factory, small brewery.

• large customers (businesses with more than 250 employees or annual consumption exceeding 5ML). Examples of these kinds of businesses include airport, power plant, oil refinery, port, large manufacturer or large brewery.

Note in the remainder of this report we refer to micro-businesses and SMEs together as ‘smaller customers’.

2.2 Customer landscape

Around 1.2 million business customers are eligible to participate in the business retail market. Reflecting the business landscape in the UK more generally, the great majority of eligible business customers in the business retail market (around 86%) are micro-businesses. We have estimated a breakdown of eligible customers by company size in Table 2.1.
### Table 2.1 – Estimated distribution of eligible customers by company size

<table>
<thead>
<tr>
<th>Company size</th>
<th>Estimated number of eligible business customers</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro (0-9 employees)</td>
<td>1,055,000</td>
<td>86%</td>
</tr>
<tr>
<td>Small (10-49 employees)</td>
<td>137,000</td>
<td>11%</td>
</tr>
<tr>
<td>Medium (50-249 employees)</td>
<td>25,000</td>
<td>2%</td>
</tr>
<tr>
<td>Large (250+ employees)</td>
<td>5,000</td>
<td>&lt;1%</td>
</tr>
</tbody>
</table>
| All                      | 1,222,000                                        | 100%

Source: CIS 2019

### 2.3 Customer awareness and engagement

#### Awareness and engagement

Overall, customer awareness of the new market and their ability to choose an alternative provider, as assessed by CIS 2019 research conducted in March to June 2019, has increased slightly, with awareness levels at around **53%**, compared to **48% in the first year of the market**. As before, awareness levels are higher among large customers (65%) and SME customers (61%), although it appears that awareness levels for larger customers have fallen somewhat in the second year, from 89% in the first year to 65% in the second year. However, when asked as part of CIS 2019 research about awareness of the possibility to switch utilities, only around 59% of business customers are aware of the possibility to switch water provider, against over 98% for telecoms or energy provider.

CIS 2019 qualitative research undertook in-depth interviews with business customers. These interviews suggest that the degree of awareness and knowledge of the business retail market varies markedly, including that it appears that many customers have a poor knowledge of potential alternative providers. ORS’s in-depth research did however highlight that **the more customers had to gain from the water market (e.g. higher usage), the more aware and knowledgeable they tended to be**.

ORS’s research findings suggest awareness levels among micro businesses and SME customers (51% and 61% respectively) are higher than those found by CCWater’s Tracking survey of small businesses. This found awareness levels of microbusinesses and SMEs of around 36% across both customer groups together in February 2019.

Engagement and activity levels are broadly unchanged in the second year of the market. Our CIS 2019 research for example found that **around 13% of customers**
have been active\(^6\) since market opening, compared to around 10% in the first year. By customer segment, CIS 2019 results suggest activity levels since market opening were around 12% for micro-businesses, around 18% for SME customers, and around 36% for large customers.

### 2.4 Motivation to switch or renegotiate

Findings from both ORS’s quantitative and qualitative research confirms that customers see price reductions as the principal benefit of engaging in the business retail market. For example, around a quarter (23%) of aware customers (those who had considered or tried to switch or renegotiate), or around 1.5% of all business customers, cited lower price/bill as a reason to start looking into switching or renegotiating. 44% of these customers, or around 3% of all customers, cited ‘incentive/cashback’. Desires for higher quality service also featured as reasons to consider switching by these customers (7%).

Over half of customers who switched or renegotiated said they looked into switching or renegotiating to save money (52% of customers who had switched since market opening, 62% of customer who had renegotiated since market opening). Around a fifth of customers who had switched since market opening (19%) also said they had started looking into switching because they were contacted by someone, such as a broker or alternative supplier, and 9% said they sought higher quality service (e.g. more tailored billing), and 10% better customer service (e.g. concerning contact with the retailer).

CIS 2019 qualitative research using in-depth interviews suggests that poor customer service – essentially not getting proper advice regarding the resolution of a problem or struggling to get in contact with the retailer in the first place – has led to a higher prevalence of smaller organisations switching, as opposed to renegotiating their contract with their existing provider.

Regarding customers who had not to date switched or renegotiated or considered doing so (‘aware but inactive’ customers) it appears that a key reason for inaction to date is a perception that the benefits of switching are low or will not exceed the costs. For example, 14% of aware but inactive customers\(^7\) said there was ‘no point in switching’. Furthermore:

- On perceptions of benefits: CIS 2019 in-depth interviews for example suggested that for those smaller organisations yet to act on switching and renegotiating,

---

\(^6\) We define a customer ‘active’ as one who had switched or renegotiated, considered switching providers or renegotiating with existing provider and had taken steps to search for and compare different providers, tried to switch or renegotiate but couldn’t, or considered switching or renegotiating but decided not to, since market opening

\(^7\) i.e. those customers aware of the market, but who have not switched or renegotiated, and who have not considered doing so, or customers who report that they plan to consider switching or renegotiating in future
there was a consensus that a saving of 15-20%⁸ on their bills would be enough of an impetus to go ahead – but the majority of these respondents did not feel this was a realistically achievable saving, leading to a reluctance to act. Furthermore, around a fifth (22%) of aware but inactive customers cite contentment with their current retailer as a reason not to act (CIS 2019).

- On perception of costs: Of aware but inactive customers, around a fifth (18%) cite “it’s too much effort to switch”, and 7% cite “don’t know how to switch” as reasons for not considering switching or renegotiating.

For larger organisations, these barriers may well be smaller, and hence switching rates correspondingly higher. CIS 2019 in-depth interviews for example found that, for medium and large organisations, the prospect of 5% bill savings were enough to motivate switching or renegotiation.

However, given that around one third (34%) of aware customers who have not switched or renegotiated say they plan to do this in future (CIS 2019), there appears to be some potential desire to engage. Better knowledge or access to information or offers may help – **one in ten (9%) of aware but inactive customers cite “Don’t know any other retailers/no alternative” as a reason for not having considered switching or renegotiating** (CIS 2019).

### 2.5 Searching and comparing

Customer engagement in the market, including their ability to find and switch to a better deal, depends significantly on how easy they find it to navigate the market, compare retailers and offers, and so shop around. An effectively functioning market requires customers – or someone working on their behalf – to make informed choices.

Findings for the second year of the market, which echo findings from the first year, suggest that **customers who had switched, renegotiated or considered switching or renegotiating since market opening commonly look to brokers (34%) as a source of information** – figure 2.1 sets out the CIS 2019 research findings here.

---

⁸ This would be a figure of £52 - £69 based on the approximate average annual bill (£345) for customers using less than 0.5Ml per year. The estimated average bill is based on Thames Water’s PR16 final determinations.
Furthermore, of customers who had searched for information, most of them (84%) reported that they found it either ‘very easy’ or ‘fairly easy’ to locate the information they required (CIS 2019). This compares to 72% of customers in the first year of the market. However, a significant minority (8%) said they found it fairly difficult. The principal reasons cited by such customers were ‘information not available via phone/online/my preferred communication method’ (95%) and ‘information found was not clear/did not understand information’ (76%) (CIS 2019 - note low base size on these findings concerning reasons for finding it difficult, hence results should be interpreted with care).

However, customers who had searched for information reported greater difficulties in their ability to compare retailers – 40% said this was ‘very easy’ or ‘fairly easy’, against 30% who reported it to be ‘very’ or ‘fairly’ difficult’, with the most often cited reason for difficulties being ‘not enough time’ (81%) (CIS 2019 – note low base size concerning reasons for difficulty, hence results should be interpreted with care).

These two findings together – that the majority of searching customers (84%) said they found it straightforward to find information, but only a minority (40%) said that they find it easy to compare retailers, suggests that customers did not always find information that would enable them to assess and compare offers from different retailers.

CIS 2019 in-depth interviews with customers support these CIS 2019 quantitative research findings. In particular, some customers during in-depth interviews reported that their knowledge of the market was not good and/or that they had little sense of who alternative retailers were or what might be on offer. Many customers during in-depth interviews said they use or rely on brokers to find or bring to their attention better deals, and this may to some extent alleviate the need for these customers to become informed about the market themselves. Larger usage customers who therefore might benefit more in overall £ savings by engaging with the market tended, during the in-depth interviews, to report being relatively well informed about the market.
Common suggestions during the in-depth interviews from customers who felt less well informed included the need to have better access to information, for example:

- the option of having fixed tariffs / banding with information that is easy to find; and
- the availability of a comprehensive price / tariff comparison site – including company ratings.

Overall these findings suggest that customers are finding it a little easier to search and compare information about the market and retailers in the market’s second year. However, it remains clear that there is significant scope for improvement.

### 2.6 Use of brokers and third party intermediaries

Brokers and third party intermediaries played a major role in many customer’s decision to switch or renegotiate. For example, CIS 2019 results included:

- a third (34%) of customers who switched, renegotiated or considered doing so used a broker as a source of information;
- around one in five (19%) customers who had switched since market opening said that they started looking into switching because they were contacted by a broker or supplier; and
- almost two fifths (39%) of switchers arranged their switches via a broker.

CIS 2019 in-depth interviews with customers found that the use of brokers was fairly widespread. Furthermore, this research found that the majority of customers who had used brokers said that they had used a broker they had a previous relationship with and that as a result, many had a high level of trust in their brokers.

Nonetheless, CIS 2019 in-depth interviews also found that some customers had experienced unwelcome ‘cold-calling’ from some brokers. The research suggested that the scale of the issue is fairly significant – although being contacted by a large number of brokers was not raised by more than around a quarter of participants. Where it was, the high frequency of the ‘cold calling’ was concerning across the board. A common suggestion put forward by those customers was a better regulation of brokers in this regard. We note that these results are based on a limited number of in-depth interviews so cannot be taken as representative of all customers as a whole.
2.7 Extent of switching and renegotiation

Customer engagement and activity in the second year of the market has translated into broadly stable switching rates across all customers as for the first year of the market, on the basis of data from MOSL, our CIS 2019 research and retailer information returns. Switching rates for large customers remain higher than for the market as a whole; CIS 2019 research suggests around 15% of large customers switched in the last 12 months, compared to about 3% for all customers surveyed. MOSL data suggest larger customers switched around 9% of supply points in 2018/19, compared to 4% switched across the market as a whole.

Furthermore, data from our CIS 2019 research suggest that renegotiation of a new deal with an existing retailer played a role almost equal to switching in terms of customer activity. For example, the CIS 2019 research suggests that around 2.4% of customers renegotiated in the second year of the market. Table 2.2 summarises the data.

Note that our CIS 2019 research gave equal prominence to both ‘switching’ and ‘renegotiating’ when asking respondents about their activity in the market. This represented a slight change on the CIS 2017 research, where questions concerning renegotiation were secondary to questions concerning switching. We think the approach in the CIS 2017 research would tend to have underestimated the incidence of renegotiation activity, all other things equal.

However, CIS 2019 data suggest that larger customers are more active in the market as illustrated in table 2.39.

---

9 Illustrative figures only; we have not here assessed the statistical significance of differences between results for customer segments
Table 2.2 – Switching rates according to different sources of evidence

<table>
<thead>
<tr>
<th>Source</th>
<th>First year of market</th>
<th>Second year of market</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dates</td>
<td>Estimated switched or renegotiated</td>
</tr>
</tbody>
</table>
| MOSL   | 1st April 2017 – 31st March 2018 | • Supply points 5%  
• Consumption 9%  
• Wholesale revenue 10% | April 2018 – March 2019 | Supply points 4%  
Consumption 6%  
Wholesale revenue 8% |
| ORS Customer Insight Survey | Fieldwork 1st April – November 2017 | • Customers switched 3%  
• Customers successfully renegotiated 1% | Fieldwork April – May 2019 | Customers switched (in last 12 months) 2.7%  
Customers renegotiated (in last 12 months) 2.4%<sup>10</sup>  
Customers switched or renegotiated (in last 12 months) 4.0% |
| Retailer data requests | 1st April 2017 – 31st January 2018 | • Billing accounts:  
Switched 1.3%  
renegotiated 1.7%  
Consumption:  
Switched 4.7%  
renegotiated 4.1%  
Revenue:  
Switched 3.4%  
Renegotiated 3.5% | April 2017 – December 2018 | Billing accounts:  
switched 3.3%*,  
renegotiated 1.9%*  
Consumption:  
switched 9.6%*,  
renegotiated 4.5%*  
Revenue:  
switched 10.6%*,  
renegotiated 4.1%* |

*Note these figures set out cumulative switching rates since market opening

<sup>10</sup>Note: We consider that our approach in CIS 2019 research is likely to be a more accurate measure of the incidence of renegotiation, compared to the approach and the results derived from, the CIS 2017 research.
Table 2.3 – Switching and renegotiation rates, by customer segment

<table>
<thead>
<tr>
<th>%</th>
<th>Source</th>
<th>All customers</th>
<th>Micro-businesses (0-9 employees)</th>
<th>SME businesses (10-249 employees)</th>
<th>Large customers (250+ employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of customers switched</td>
<td>CIS 2017/18</td>
<td>3.0</td>
<td>2.8</td>
<td>3.3</td>
<td>6.6</td>
</tr>
<tr>
<td>between April 2017 - November 2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proportion of customers renegotiated</td>
<td>CIS 2017/18</td>
<td>0.9</td>
<td>0.9</td>
<td>0.5</td>
<td>1.9</td>
</tr>
<tr>
<td>April - November 2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proportion of customers switched in</td>
<td>CIS 2019</td>
<td>2.7</td>
<td>2.9</td>
<td>1.7</td>
<td>15.2</td>
</tr>
<tr>
<td>last 12 months (i.e. over period April</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018 to May 2019)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proportion of customers renegotiated</td>
<td>CIS 2019</td>
<td>2.4</td>
<td>1.9</td>
<td>5.5</td>
<td>4.3</td>
</tr>
<tr>
<td>in last 12 months (i.e. over period</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>April 2018 to May 2019)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Customer insight survey 2017/18, Customer insight survey 2019

2.8 Experiences of the switching process

Where customers decide to switch retailers, an effectively functioning market requires that they can do so quickly, easily and without hassle.

The evidence suggests that most customers who switched experienced a smooth process. CIS 2019 research found that the great majority of switchers reported that they found the switching process to be either ‘very’ or ‘fairly’ easy (93%), and that they were ‘very’ or ‘fairly satisfied’ with the length of time it took for the switch to take place (90%).

Nevertheless, CIS 2019 research findings include that a minority (5%) of switchers reported that the switching process was either ‘very’ or ‘fairly’ difficult. Furthermore the findings suggest that many of these customers experienced a range of problems and difficulties. These included difficulties with coordinating the old and new retailers, disputes over final bills and meter reads as well as the amount of time and effort involved in resolving these disputes.

11 Illustrative figures only; we have not here assessed the statistical significance of differences between results for customer segments
2.9 Customer outcomes being achieved

Our customer insight survey CIS 2019 suggests that many customers experience benefits from switching or renegotiating – with **two thirds (68%) of switchers who switched in the last 12 months and nearly four fifths (77%) of renegotiators who renegotiated in the last 12 months reporting price savings**. Customers who switched in the last 12 months also reported other benefits from switching, such as receiving higher quality service (7%), better customer service (8%) or being able to consolidate bills (e.g. 5% cited bill consolidation for water and waste water services).

Furthermore, **over four fifths (85%) of switchers who switched in the last 12 months and nine in ten (90%) of renegotiators who renegotiated in the last 12 months reported that the benefits of switching or renegotiating met or exceeded their expectations**.

Consistent with our assessment of the first year of the market, this report assesses benefits to customers from saving money, water and time. It also assesses the extent to which market opening has resulted in wider ‘spillover’ benefits. It also notes the continued growth of the self-supply retailer model; i.e. customers who hold a retail licence that allows the customer to ‘self-supply’ water services.

**Money savings**

Our CIS 2019 research found that of customers who had switched or renegotiated in the last 12 months (and excluding those who reported ‘too early to tell’ or did not report % savings), around two thirds (63%) of switchers and around half (51%) of renegotiators reported price savings of 5% or lower.

**Average savings achieved by those who switched or renegotiated, compared to default tariffs, was around 2%** (retailer information returns). **This compares to average savings of around 3% across the market in its first year** (retailer information returns).

Using data from MOSL and retailer information returns, we have assessed the level of savings accruing in the second year of the market to those customers who had switched or renegotiated in the first or second year. We have estimated ‘realised savings’ which takes into account the profile of switching in the second year of the market, and ‘annualised savings’ which is an estimate of the savings that would accrue across the whole year had all switchers and re-negotiators switched or renegotiated at the beginning of the year. **Table 2.4 sets out our estimates.**
Table 2.4 – Estimated aggregate financial savings by customers

<table>
<thead>
<tr>
<th>Estimated Financial savings</th>
<th>First year of market (2017/18)</th>
<th>Second year of market (2018/19)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Realised savings</td>
<td>Annualised savings</td>
</tr>
<tr>
<td>All customers</td>
<td>£8 million</td>
<td>£12 million</td>
</tr>
</tbody>
</table>

Changes in aggregate savings in the second year have been driven by three principal effects:

- A larger set of customers have switched or renegotiated, so increasing the aggregate level of 'switched' or 'renegotiated' revenues. These revenues are subject to price savings relative to default tariffs; all other things equal, this will increase aggregate savings in the second year;
- A reduction in the average level of price discounts achieved relative to default tariffs, from around 3% to around 2%; all other things equal, this will reduce aggregate savings in the second year;
- Renegotiation activity appears to have proceeded at a much slower pace in year 2 compared to year 1 – savings from renegotiation represented about half of total realised savings in year 1 compared to about a quarter of total realised savings in year 2; all other things equal, this will reduce aggregate realised savings in the second year.

**Overall, we estimate that aggregate savings have marginally increased in the second year.**

Our estimates of savings are subject to uncertainty and we have sought to take a conservative approach. We have not for example included financial savings that may have arisen from customers achieving water efficiency measures or net time savings. Our principal assumptions for estimation are:

- customers had switched around 11% of revenue, and renegotiated around 4% of revenue by the end of 2018;
- customers who switched or renegotiated saved on average 2%, compared to default tariffs, over 2018/19;
- the profile of the volume of switching during 2018/19 was determined with reference to monthly wholesale revenues switched (data from MOSL); and
- savings from renegotiation are about one third of the savings from switching.

**Water savings**

The business retail market currently accounts for about 1 million ML of annual water consumption, about a quarter of national water supply in England and Wales.
Furthermore, many of the largest individual consumers of water are customers eligible to choose their water services provider within this market. This means the market, by enabling business customers to choose retailers and services aimed at better managing water consumption and usage, has the potential to deliver significant water savings and contribute to reduced pressures on infrastructure, abstraction and the environment.

Larger customers who have elected to become self-supply retailers have particularly demonstrated the scope for business customers to achieve water savings. On the basis of data provided by self-suppliers, estimated volume savings achieved between 3 self-suppliers from moving to self-supply were around 150 Ml in 2018, equivalent to about 1% of overall annual consumption volumes of the self-suppliers reporting such savings.

More generally, across all business customers, our CIS 2019 research suggests that a small but significant proportion of customers are interested in using water efficiency services, given that 5% of all customers reported that water efficiency, leakage control and enhanced metering services are important to them as a water customer. Of customers who switched since market opening, around 4% (or about 0.2% of all customers) reported that, as a result of switching, they were now receiving new water efficiency or leak detection services, rising to 22% among those who had renegotiated since market opening (or about 0.7% of all customers). However, only around 0.3% of switchers reported that ‘leakage control services’ as a benefit of switching, with around 4% of re-negotiators suggesting that water efficiency services were a benefit of renegotiating.

We have examined the extent to which the business retail market has enabled greater take up of water efficiency services and so reduced consumption. Early indications are that customers who switched tended to reduce consumption. In particular, data available from retailers for a sample of customers who switched in April 2017 (i.e. the first month of market opening) indicates that average consumption between 2017/18 and 2018/19 fell by on average around 5%.

We emphasise that this data is highly indicative and the sample size of customers who switched in April 2017 for whom we have data is small (around 200 customers). We intend to return to this question in subsequent analyses of the market with a view to expanding our data set here. On this basis we have not estimated Ml savings that may have accrued in the second year of the market.

**Focus on water efficiency**

Customer interest in, and take up of water efficiency or leak detection services remains low, with just 0.3% of switchers and around 4% of renegotiators reporting these as a benefit of switching. Nevertheless there is some evidence that customer interest in such services outstrips take up – for example around 12% of
large customers, who may stand more to gain from such services, report that they are interested (CIS 2019). Furthermore, retailers are increasingly offering water efficiency services such as water audits, on-site leakage detection and water use benchmarking, and many prominently advertise these on their websites.

However, it is less clear to what extent water retailers proactively offer these services to customers or are prepared or able to invest in the necessary metering, equipment and longer term arrangements necessary to deliver more significant savings, particularly for smaller customers. Our market monitoring has highlighted that some barriers to the adoption of further water efficiency remain at all levels of the market.

For some customers, it may not be at all clear that the benefits in terms of likely bill reductions from reduced water consumption will exceed the financial or time spent costs involved in procuring or installing water efficiency or leak detection services. Such perceptions may continue to inhibit take up.

Even where a customer perceives there may be such benefits, more efficient water usage and leakage reduction can only be delivered by a retailer where the customers’ water consumption is measured accurately and frequently. A number of retailers have reported difficulties in obtaining the necessary meter reads and/or accessing meter/logging equipment, which can constitute a key barrier to the offer of water efficiency services. We have also heard anecdotal evidence from customers (and brokers working on their behalf) that customers are interested in using water more efficiently, but are unable to do so because their bills do not reflect their actual consumption of water (e.g. because meters have not been read or because they are being billed incorrectly). The clear message from these customers is “if you can't measure it, you can't manage it”.

For wholesalers, the regulatory regime imposes incentives on them to manage their use of water resources. Following market opening, there is no longer a clear and direct relationship between these companies and end customers such that their ability to influence water usage directly may be reduced. Some wholesalers have sought solutions – for example, Thames Water is trialling a financial incentive scheme to encourage retailers to help end customers use water more efficiently, and Bristol Water is offering its water efficiency services to other retailers as a ‘white-label’ resale product.

We believe, on the basis of customer interest and in view of a number of possible barriers to take up, that there remains untapped potential for continued development in the offer and take up of water efficiency services.

**Time savings**

Market opening has provided an opportunity for customers to seek more efficient administration of the water services they receive, thereby saving both time and money. Consolidated billing – bringing billing, premises, and/or water and other utilities to one retailer – is a key enabler of such savings. We also note that around a
quarter of retailers (based on retailer information returns) report that they have sought to offer more streamlined and time efficient account management as a way of meeting customer demands for such services and as a competitive differentiator.

Our customer insight survey (CIS 2019) found that consolidating billing in this way has prompted some customers to think about switching; around 13% of customers who switched or renegotiated since market opening said they started looking into either switching or renegotiating in order to consolidate their bills for either clean water and wastewater, across multiple premises, or multiple utilities. Furthermore 27% of large customers who had switched since market opening said ‘bill consolidation across multiple premises’ was a reason they starting looking into switching. Around one in twelve (8%) of customers who had switched since market opening cited some form of consolidated billing as a benefit of switching. 21% of large customers who switched said bill consolidation across multiple premises was a benefit of switching (against 2% of all switchers) (CIS 2019 results).

Furthermore, around 19% of switchers who had switched since market opening said the amount of time spent on dealing with water bills each billing cycle had fallen since switching. On the other hand, around 12% of switchers who had switched since market opening said their time so spent has increased.

‘Spillover’ effects

The introduction of competition in the business retail market could deliver customer benefits beyond business customers. So called ‘spillover’ effects could extend to, for example, household customers. These effects might occur as retailers put pressure on wholesalers to deliver price, service or operational improvements. Wholesalers may then pass on these benefits through to both business and household customers. The introduction of competition also creates new opportunities for both wholesalers and retailers to experience, and react to, competitive pressures, including greater transparency and learning concerning how best to meet end customer needs.

Our review of such effects in the first year of the market found that most wholesalers considered the market too nascent to assess whether such benefits were arising. Nevertheless, many were optimistic that such benefits could arise as the market matures. Open for business noted that two wholesalers – South East Water and Southern Water – detailed two initiatives they developed for the business retail market which could furthermore benefit household customers and the NAV market respectively12.

Wholesalers report further evidence of spillover benefits to customers in the second year of the market. Examples cited include:

12 See §7.6 Open for business
State of the Market: reviewing the second year of the business retail market

- improvements in data/operations, where processes for switching or administrating business customers’ accounts enable data quality improvements for household customers (see box below);
- metering improvements, which was the most frequently cited spillover effect, with many wholesalers applying methods to reduce the number of long-unread meters and legacy metering issues to the household retail market; and
- operational benefits - one wholesaler is preparing to run its wholesale and household retail businesses separately after noting for example the potential for meter reading, billing and revenue collection efficiencies in the business retail market.

Some wholesalers said that they continue to see additional services spilling over to the household retail sector, with features similar to South East Water’s ‘in your area portal’, featured in last years’ report\(^\text{13}\), becoming more prevalent.

Noting that the business market has only relatively recently opened and that spillover effects take time to emerge and quantify, most wholesalers have not at this stage quantified any spillover benefits. Nonetheless, of those that have, total reported one-off benefits across these wholesalers sum to around £600k. The size of these benefits individually range from £5k to £400k.

Wholesalers have also mentioned the Retailer Wholesaler Group (RWG) in the context of spillover benefits, particularly regarding the groups’ work around industry issues such as data logging and leakage allowances. They see potential for good practice emerging in the business retail market also to be adopted in the household sector.

**Benefits for households owing to data improvements in business market**

Northumbrian Water have noted that the business retail market has increased its focus on data quality issues, which could in turn help drive customer service improvements for household customers.

This is because the market switch / transfer process effectively acts as a full ‘review’ process for a range of data items related to a particular supply point, and so enables Northumbrian to highlight data anomalies for correction. Where these relate to a mixed use and shared supply arrangements, household customers as well as business customers may benefit from consequential improved customer service.

Northumbrian noted that they would in due course anticipate that any lessons learned from more detailed trend analysis of these data quality issues should

\(^{13}\) See §7.6 *Open for business*
enable them to further proactively review or introduce validation programmes for household customers, with consequential improvements in customer service.

Self-suppliers

As we note in annex A1, Ofwat licensed five new self-supply retailers during the market’s second year (Blackpool council, British Telecom, Elis/Berendsen, Heineken, Stonegate Pub Company) joining the four licensed in the first year (Coca-cola, Greene King, Marstons, Whitbread).

Our ongoing engagement with self-suppliers (principally via the self-supply User Forum, as well as on the basis of information returns from self-suppliers) suggests that self-suppliers continue to reap benefits from this business model. On the basis of information provided by those self-suppliers who reported information, these benefits include:

- **Ongoing cost savings** – Self-suppliers reported an average cost saving of 3.5%. Some realised further financial savings owing to business efficiency improvements achieved as a result of operating as a self-supplier. In addition to price savings from switching, reduced leakage through more frequent metering and reduced administrative costs through monthly billing were cited as reasons for these additional savings.
- **Reduced water consumption** – Self-suppliers reported they had either reduced or expect to reduce water consumption, enabled for example by more frequent meter readings and/or increased use of AMRs (‘automatic meter reading’).
- **Better control over consumption data and accurate and regular billing** – Control over data was a benefit reported by self-suppliers, mainly due to the ability to add meter reads and engage bilaterally with wholesalers. Furthermore regular billing has led to simplified validation of charges and reduced administrative burden.

As we set out in annex A1, we also note that a few self-suppliers are not yet, or have needed time to become, active in the market, and that some have faced issues with wholesalers. Nevertheless we also note that some self-suppliers have also reported that wholesalers are increasing their efforts to cooperate with and resolve issues experienced by self-suppliers.

### 2.10 Satisfaction, dissatisfaction and complaints

The majority of customers appear to be satisfied with their current retailers, with around four fifths (80%) of all customers reporting that they are either ‘very’ or ‘fairly’ satisfied – levels largely unchanged from the first year (77% satisfaction levels) (see figure 2.2). On the basis of our CIS 2017/18 and CIS 2019
research, the **principal drivers of dissatisfaction continue to be billing issues** (60% of dissatisfied customers) and **poor customer service** (48%), though these proportions are lower than for the first year of the market (74% and 63% respectively).

Problems with customer service and billing are leading issues cited by customers where they have had any problems and/or contact with their retailer. For example CIS 2019 research found that 6% of all customers had experienced a problem with their retailer in the last 12 months, with a quarter (24%) of these - or around 1.5% of all customers (i.e. around 18,000 customers in total) - citing problems with customer service such as billing in the last year.

We note moreover that CIS 2019 in-depth interviews suggest that better levels of satisfaction seemed to stem from the customer not having to deal with the retailer regarding any problems in the first place, rather than the retailer delivering better levels of customer satisfaction, e.g. by offering unique or bespoke services.

Customer complaints provide an additional and important indicator of customer satisfaction. Customers may escalate complaints to CCWater, and proceed to Alternative Dispute Resolution in case of unresolved complaints. Ofwat also receives direct complaints from customers\(^\text{14}\).

**Figure 2.2 – Satisfaction with retailer**

![Satisfaction with retailer chart](source: CIS 2017 and 2019)

\(^{14}\) Note we would expect that customers would have referred their matter to CCWater prior to any complaints which CCWater could not resolve being considered by us. For further details on Ofwat’s role in considering complaints, see: How we investigate complaints.
As set out in table 2.5 and figure 2.3, complaint levels have increased significantly following market opening. The majority relate to billing and charging as well as administration, as illustrated by figure 2.3.

### Table 2.5 – Total business customer complaints

<table>
<thead>
<tr>
<th>Type of complaint</th>
<th>April 2016 – March 2017</th>
<th>April 2017 – March 2018</th>
<th>April 2018 – March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written complaints to retailers</td>
<td>11,772</td>
<td>14,885</td>
<td>17,918</td>
</tr>
<tr>
<td>Complaints to CCWater</td>
<td>824</td>
<td>2,780</td>
<td>3,975</td>
</tr>
<tr>
<td>Complaints to Ofwat</td>
<td>NA</td>
<td>327</td>
<td>482</td>
</tr>
</tbody>
</table>

Source: CCWater\(^{15}\), Ofwat

### Figure 2.3 – Customer complaints received by CCWater

CCWater have collated their complaints statistics by retailer, normalised against the customer base of each retailer measured by supply points served, as set out in figure 2.4.

\(^{15}\) See in particular: CC Water. Non-household customer complaints to water retailers, water companies in Wales, and Consumer Council for Water 1 April 2018 - 31 March 2019
Figure 2.4 – Business customer complaints to CCWater and written complaints to retailers, per 10,000 supply points in 2018-19

*Measured in connections rather than SPIDs

Source: CCWater
3. **Market functioning**

### Summary

The second year of the market has seen the sector take some steps to improve market functioning, including by starting to address the three main market frictions we identified in *Open for business*:

1. Wholesaler performance;
2. The quality of market data, and
3. Wholesaler – retailer interactions.

However all three types of market friction persist, and progress in addressing them has been slow, undermining the development of effective competition and leading to worse outcomes for customers. Urgent action to resolve these market frictions, with all market participants playing their part, is necessary to benefit customers.

Aggregate performance by wholesalers has improved in the second year of the market. Overall wholesalers completed 80% of Market Performance Standard (MPS) tasks, for example concerning missed meter reads, on time in year 2, compared to 66% in year 1. While a third of all wholesalers completed 88% or more tasks on time in year 2, significant variance remains across individual wholesalers’ performance in year 2, with completion on time rates ranging from 60% to 97%. Levels of performance from some wholesalers clearly need to improve to support more effective market functioning.

Market parties, working with MOSL, have made some improvements to data quality – for example, instances of poor data in settlements (‘user exceptions’) have fallen by almost 90% over the year to March 2019. However, progress has been slow and in some cases – for example timeliness of meter reads – performance has deteriorated. The proportion of meters not read for over a year for example increased from 12.5% to 14.4% in the year to March 2019.

In 2018/19, retailers and wholesalers have begun to make progress on improving wholesaler - retailer relationships and interactions. Some retailers attribute this in part to improved communications developed in response to supply interruption events in 2018. Nevertheless we note that wholesaler-retailer interactions do not always run smoothly, and that poor wholesaler-retailer interactions create a poorer experience for end customers.

In the second year of the market, MOSL and the Industry Panel have proactively undertaken work to identify and work with trading parties who are performing poorly against industry standards and to improve data quality. They are starting to hold parties to account through the publication of market dashboards and league tables of performance. MOSL’s market operating plan for the third year of the
market recognises that significant further work is required and includes clear commitments to improve the incentives trading parties are subject to as well as data quality.

Following a call for inputs (CFI) in November 2018, Ofwat has recently published a CFI outcomes report on wholesaler performance. This report notes that some progress has been made to address frictions arising from wholesaler performance and wholesaler – retailer interactions. However further urgent action is required. The report outlines a number of specific actions and timelines to achieve these.

3.1 Introduction

An effectively functioning market is key to delivering better outcomes for customers. All market parties have a role to play in ensuring that the market functions well, including:

- Wholesalers, who provide infrastructure, meters and services necessary for retailers to be able to operate and offer good quality customer service;
- Retailers, who are responsible for the customer relationship, including customer service, meter reading and billing, as well as the procurement of relevant products and services from wholesalers; and
- MOSL, which operates systems for customer switching and wholesaler-retailer transactions, and acts as the administrator for industry codes.

Ofwat, as the sector regulator, has a duty to protect the interests of customers, including where appropriate through the promotion of effective competition. In meeting this duty we have a role in ensuring that companies meet their obligations as set out in legislation, licences and market codes.

In this section we assess how well the market has been functioning in its second year, and the initiatives underway to make further progress in the third year of the market and beyond. We focus on the market frictions identified in last year’s Open for Business report.

3.2 Recap of market frictions

Our first review of the market, Open for business, identified three broad issues – or market frictions – that were impeding efficient market functioning and hence the delivery of better customer outcomes. These were:
• a lack of complete, accurate and timely market data – for example there continues to be a number of incomplete or missing data items and inaccurate customer data;
• poor aggregate performance of wholesalers against the industry standards across the market, as wholesalers completed only two thirds of their tasks on time, with 37% of meter reads submitted late; and
• some inefficient and ineffective interactions between wholesalers and retailers which, at times, has made it difficult for retailers to operate; for example, poor communication between wholesalers and retailers can leave end customers confused about who to talk to.

We noted these market frictions could increase retailer costs and hinder their incentives to reach out to certain customer groups, particularly smaller businesses. We also noted that a lack of complete, accurate and timely market data is likely to undermine retailers’ ability to offer value added services such as water efficiency measures. We noted that these frictions were not only affecting customers engaging in the market, but also acting as a potential barrier to wider customer awareness and engagement.

In last year’s report we emphasised that all market participants had a role in resolving market frictions and that this would be essential for customers to experience the full benefits of a well-functioning market.

### 3.3 Developments in the second year of the market

Market arrangements are now better established. Trading parties and MOSL have continued their work aimed at improving the functioning of the market’s architecture and processes. For example:

• In October 2018 MOSL published its first Market Performance Operating Plan 2018/19 and 2019/20 (MPOP), outlining plans for MOSL and trading parties to address key market issues and risks;
• Trading parties’ work and cooperation: retailers and wholesalers established the Retailer – Wholesaler Group (RWG) tasked with identifying common retailer-wholesaler issues and progressing solutions;
• The freeze / thaw events of 2018 resulted in water supply interruptions for many customers and – together with the drought events of 2018 - revealed that trading parties were not as prepared as they should have been. A code change was subsequently developed, alongside RWG guidance, which is intended to encourage better sharing of customer emergency contact details. WaterUK and the UK Water Retailer Council (UKWRC) have also been working together to develop a plan focused on ensuring that trading parties better manage extreme weather impacts on business customers; and
State of the Market: reviewing the second year of the business retail market

- Governance of and amendments to the industry Codes – in 2018/19, there were 30 code changes, 28 of those being led by the trading parties. Two were led by Ofwat, including one change to the Customer Protection Code of Practice ("CPCoP")\(^\text{16}\). Ofwat approved all Code changes, including the Panel’s resubmitted recommendations in respect of the financial penalties regime for the Market Performance Standards \(^\text{17}\).

We have assessed market developments through a variety of sources, including our ongoing market monitoring work, formal information requests to retailers and customer views.

In addition MOSL, as part of its responsibilities, maintains oversight of the market and developments through, among other things, its monitoring of trading parties’ performance against required industry standards. In its Annual Market Performance Report 2018/19 (AMPR) MOSL has reviewed trading parties’ performance in the second year of the market. It set out a number of initiatives it has led with a view to improving performance where necessary and so enhancing overall efficient market functioning.

The remainder of this section sets out our key observations on market functioning in its second year and initiatives for the third year and beyond. It is structured according to the three market frictions highlighted in our assessment of the first year of market operation outlined in section 3.2.

**Wholesaler performance**

**Market performance framework**

Wholesaler and retailer performance in the market is currently governed by the Market Performance Framework (MPF)\(^\text{18}\), which includes two sets of standards. Market Performance Standards (the MPS standards) are standards which scrutinise the performance of both wholesalers and retailers; whereas Operational Performance Standards (the OPS standards) apply to the wholesalers alone. MOSL monitors performance under these standards.

The MPS standards relate to processes where underperformance is likely to have an adverse impact on the orderly operation of the market – for example concerning the submission of meter reads. The OPS standards relate to processes between wholesalers and retailers (bilateral processes), which facilitate efficient functioning of

---

\(^{16}\) The Customer Protection Code of Practice ("CPCoP") sets out the minimum standards that all retailers must comply with in their dealings with non-household customers. It also sets out the minimum standards of behaviour that we expect from retailers.

\(^{17}\) See Ofwat decisions: Market arrangements Code change Proposal CPM008, Market arrangements Code change Proposal - Ref: Revised CPM008

\(^{18}\) See www.mosl.co.uk for further details – in particular Market performance framework; and Annual Market Performance Report 2018/19
the market, such as prescribing timescales for completing physical connections or meter replacements.

There are two types of incentives on trading parties to meet these standards: reputational incentives (i.e. published performance of each market party), and financial incentives (i.e. charges levied on trading parties where they fail to meet relevant standards). MPS financial penalties are subject to a monthly cap, set at 0.15% of trading parties’ primary charges.

Both the MPS and OPS regimes for 2018/19 were amended from those applying in 2017/18, for example concerning the way performance standards are measured and level of charges. We note that an amended regime has the potential to alter absolute and relative performance of individual trading parties, even where their performance has not materially altered over the two years – all other things equal.

**Performance against the Market Performance Standards (MPS)**

In April 2018 financial and reputational incentives came into effect with the aim to drive up wholesaler performance against MPS. MOSL data suggests that, out of around 172,000 tasks completed by wholesalers under the MPS in the second year of the market (April 2018 – March 2019), around 80% were completed on time. This represents an improvement in performance since the first year, when the rate was about 66%. Only one wholesaler - South West – saw performance deteriorate in year two.

**Retailers’ aggregate MPS performance deteriorated in the second year – with only 75% of tasks completed on time, against 89% in year one**. Almost all retailers, with the exception of Water2business and Affinity for Business, saw their performance worsen.

We note that wholesalers and retailers have been working to address data quality problems, and we discuss this further below. We note in this context that, as MOSL have highlighted in their AMPR, where data is being cleansed and backlogs of work undertaken and submitted to the Central Market Operating System (CMOS), this can lead to a temporary deterioration in trading party performance against market standards (both MPS and OPS).

**Nevertheless, it remains the case that there is substantial variation in wholesaler and retailer performance, and that in some wholesale regions, wholesaler performance has been particularly poor.** Regarding wholesalers, performance against MPS ranges from Bristol Water and Dŵr Cymru Welsh Water at 97% to Southern and South East Water, both at 60%. Regarding retailers,

---

19 For overview see Ofwat decision: Wholesale Retail Code and Market Arrangements Code Change Proposal - Ref CPW030; and detailed changes at MOSL: https://www.mosl.co.uk/#scroll-track-a-change

20 In respect of retailers with more than 5,000 SPIDs
performance in 2018/19 varies from Yorkshire (91% tasks completed on time) to SES Business Water (55%).

Figures A2.1 to A2.5 in annex 2 set out performance indicators as well as the financial penalties levied under the MPS regime on wholesalers and retailers in the second year of the market.

**Overall, performance by both wholesalers and retailers in the second year of the market against MPS standards remains below the level we would expect would support effective market functioning.** Ineffective market functioning is likely to be compounded in wholesale areas where some wholesalers are performing below the industry average.

**Performance against the Operating Performance Standards (OPS)**

Wholesaler performance against the OPS standards has improved slightly since last year. **In the second year, in aggregate, wholesalers completed 63% of OPS tasks on time, against 58% in the first year of the market**\(^2\). Tasks related to meter installation, meter accuracy testing, and faulty meter repair or replacement account for around 20% of OPS tasks, with wholesalers completing in aggregate around 56% of these tasks on time.

Again, **performance varied markedly between wholesalers.** In the second year of the market, three wholesalers completed 96%-97% of tasks on time, while one wholesaler - Thames - completed only 33%. South West Water, Southern Water and Severn Trent Water completed fewer than 70%.

Figure A2.5 in annex 2 sets out wholesalers’ performance against the OPS standards.

As we note above, **wholesaler performance remains below the level we expect to support efficient market functioning.** Moreover improvements against the first year have been marginal. Wide variations in performance by wholesalers are likely to mean that retailers find it more difficult and costly to offer a nationwide service, which is likely to impede the development of effective competition and lead to worse outcomes for customers.

As of 1 April 2019, new reporting requirements came into effect for OPS. This means that OPS can now operate fully as a reputational and financial incentive. We hope that this will further incentivise an improvement in wholesaler performance against OPS standards for the 2019 / 20 financial year.

---

\(^2\) Note: We have calculated OPS performance as:
Tasks completed on time ÷ (Number of tasks completed within reporting period + Number of tasks outstanding at end of reporting period outside time permitted)
Strengthening wholesaler performance and service: Ofwat Call for inputs

In November 2018, in light of concerns that the reputational and financial MPF incentives outlined above were insufficient to encourage wholesalers to deliver high quality performance of services, we published a Call for inputs. This focused on how to strengthen incentives on wholesalers to improve performance. It set out four key areas of concern:

1. improving interactions between wholesalers and retailers;
2. improving measures of wholesaler performance;
3. strengthening reputational incentives; and
4. strengthening financial incentives.

In June 2019, and in the light of views received in response to the CFI, we published our CFI Outcomes Report.

Based on evidence received, the report highlights a number of shortcomings associated with the current MPF and the incentives regime. We support MOSL’s commitment in its recent Market Performance Operating Plan 2019/20 (MPOP) to review and update the MPF - focusing on simplification and strengthening links to customer outcomes. This is crucial to ensure that the framework incentivises behaviours consistent with delivering improved customer outcomes. The report highlights the need for the sector to take urgent action to resolve market frictions and clearly indicates where we expect to see further progress made by specific dates.

Data quality

In the second year of the market, trading parties as well as MOSL have worked towards addressing data quality issues i.e. the lack of complete, accurate and timely market data. For example, MOSL increased its focus on improving the accuracy of data held in the central settlement CMOS database, including through cooperation with retailer and wholesalers.

This has resulted in some improvements over the year. MOSL has for example recorded a roughly 90% reduction in monthly ‘user exceptions’ – instances of missing or incorrectly formatted data given as part of the retailer-wholesaler settlement process (figure 3.1). Furthermore, MOSL has highlighted that there have also been some improvements in key data items such as ‘Yearly Volume Estimates’ (YVEs), a key metric used where actual meter reads are not available.
However, significant data quality issues remain. MOSL’s AMPR for 2018/19 for example highlighted that the key data necessary for accurate customer billing – i.e. meter reads and consumption data - are too often inaccurate, incomplete and/or submitted late. Furthermore, performance in the key area of the timeliness of meter reading has deteriorated rather than improved. In March 2018, 12.5% of meters had not been read for more than a year. By March 2019 this proportion has increased, rather than decreased, to 14.4% (figure 3.2).

Evidence from our customer insight survey, complaints received by CCWater and anecdotal evidence from customers and their representatives, continues to indicate that many customers continue to experience problems with inaccurate billing – including customers who have switched retailers. Inaccurate or disputed billing in part arises as a result of inaccurate or late delivered data to MOSL’s central data system (CMOS).
Trading party performance against the MPS and OPS standards can compound data quality issues. For example, aggregate wholesaler performance has been poor against the MPS standards relating to late or missed meter read submissions\(^{22}\) where wholesalers completed 21% of tasks late in 2018-19. Similarly, aggregate retailer performance against MPS standards regarding late or missed meter reads\(^{23}\) has been poor – retailers completed only 75% of these MPS tasks on time in 2018/19. Poor performance against these measures will impede the provision of timely and accurate bills to customers.

**Wholesaler - retailer interactions**

Customers engaging with the business retail market depend on services provided or facilitated by wholesalers. For example, wholesalers provide metering equipment and carry out leakage investigations. Retailers act on behalf of customers where wholesaler activity or services are required for the benefit of the end customer – for example, retailers make operational requests to wholesalers for meter exchanges and regarding sewerage and/or leakage allowances. These are known as bilateral requests. Effective market functioning and a good customer experience depend on wholesalers and retailers interacting effectively and reliably to meet end customers’ needs. This requires efficient processing of the bilateral requests.

In their information returns to us, retailers have indicated that their working relationship and communications arrangements with wholesalers have improved in the second year of the market. Some retailers attribute this partly to improved

\(^{22}\) Market Performance Standards MPS 7 to MPS 14  
\(^{23}\) Market Performance Standards MPS 15 to 19
wholesaler – retailer communications developed in response to supply interruption events in 2018\textsuperscript{24}.

The dry weather and the freeze-thaw events of 2018 identified vulnerabilities in the relationships between wholesalers and retailers, specifically in ensuring a consistent and coherent approach towards managing the impact of extreme weather on business customers. Updates to the Codes were subsequently made, alongside the development of market guidance, both of which are intended to improve processes and communication during such events.

While we have yet to see whether these arrangements are adequate to deal with future severe weather events, we are aware that the RWG is revisiting its unplanned events guidance to ensure it is fit for purpose. WaterUK and UKWRC are also developing a plan to improve coordination between their members and determine whether further updates to the Codes are necessary. We recognise that supply interruptions and poor drought management processes can have a significant financial impact on manufacturing and agricultural businesses. We therefore encourage wholesalers and retailers to continue to look at ways to improve coordination during such events.

Nevertheless, information from our ongoing market monitoring work and discussions with trading parties continues to highlight that wholesaler-retailer interactions do not always run smoothly, particularly concerning bilateral requests. Where an end customer needs to rely on a retailer to coordinate or resolve requests or queries with a wholesaler on their behalf, difficulties or frictions in these interactions can create a poorer experience for end customers.

Our customer insight research in-depth interviews with customers highlighted how customers can experience these difficulties. Customers who commented on difficulties about wholesaler – retailer interactions highlighted the lack of a ‘one-stop’ shop in particular. They were unable to rely on one party (in particular the retailer) to pursue and resolve issues or questions, for example replacement of a faulty meter. One customer for example commented:

“\textit{In the past we could talk to [wholesaler] water engineers directly and get things sorted, […] but it’s just in the last few months that they’re saying we can’t talk to them directly […] There is a level of concern for me that issues will drag on and on under the new system.}”

\textit{(SME, Administrative and Support Services)}

Our market monitoring work, including discussions with retailers, has highlighted the following issues which continue to impact on wholesalers and retailers interacting effectively:

\textsuperscript{24} For example, the supply interruptions in February/March 2018 – see Ofwat’s June 2018 report \textit{Out in the cold}
• inconsistencies in the wholesalers’ approach – for example, individual wholesalers have different criteria for acceptance and/or rejection of requests; time spent by retailers on producing these requests unnecessarily prolongs the timescales for resolution of customers’ problems;

• wholesaler policy approaches, such as leakage and return to sewer allowances, can still vary significantly from region to region. Retailers report that language and terminology used in policy also varies, which can make navigating and understanding wholesaler policy a complex and costly task for retailers;

• poor communication – for example, not all wholesalers are active in communicating progress on requests, or, in some cases whether the request has been rejected and any reasons for this;

• lack of consistent and appropriate incentives or KPIs on wholesalers – some customers have suggested that the KPIs on wholesalers, for example timescales to respond to or implement requests (e.g. to exchange a meter), can vary between wholesalers and/or are insufficiently stringent; and

• lack of a relevant dispute mechanism - where a customer’s complaint remains unresolved after escalation to CCWater, the customer may seek independent adjudication. However, currently such dispute resolution mechanisms for non-household customers only provide for adjudication between customers and retailers, not between customer and wholesalers.\(^{25}\)

We note that MOSL has engaged the sector with the aim of developing a central bi-laterals solution for the market – that is, a central solution that aims to significantly improve the quality and standardisation of bilateral engagement and integration between wholesalers and retailers. This solution should contribute to lower costs, improve integration between wholesalers and retailers, reduce the need for manual reconciling of data issues, improve data quality and insight, and improve the customer experience. We are fully supportive of the development of such a solution to help reduce the frictions in the market, and plan to support MOSL on various aspects of this work, including by raising a code modification to establish a clear process and timetable for the design and development of such a solution.

### 3.4 Ongoing work to address market issues

All parties - retailers, wholesalers and MOSL, as well as Ofwat - have a role to play in addressing the market frictions discussed above. Table 3.1 summarises the principal activities that MOSL and trading parties have committed to with a view to addressing market frictions in year 3 of the market and beyond. This is not an

\(^{25}\) This issue arises because a customer’s contract is with the retailer and not the wholesaler. If the customer’s complaint lies wholly with the wholesaler and its decisions, there is no formal mechanism for the retailer to pass the entirety of complaint to the wholesaler or any case/compensation fee that might result. Dispute resolution in these cases currently relies on ad hoc arrangements between retailer and wholesaler. The industry has recognised the issue and is considering what steps may be needed to be taken to address it.
exhaustive list – for example MOSL’s Market Performance Operating Plan also identifies a range of data quality items it plans to address.

We welcome this work. However we remain concerned that progress during the second year of the market to address market frictions remained slow and that, in some cases, performance and outcomes have deteriorated. It is crucial that all trading parties remain committed to achieving effective market functioning and supporting the development of competition. We look to trading parties to play their full part alongside MOSL and Ofwat to ensure this.

As noted above, our CFI Outcomes Report on wholesaler performance clearly sets out our expectations of what further work remains, and the areas for priority action by industry. Given the identified shortcoming of the existing incentive framework, we support MOSL’s commitment to review this and look forward to seeing the detailed plan for this work by the end of 2019.

We have also written to incumbent water companies to make it clear that overall wholesaler support for the development of effective functioning markets is currently unacceptable. The letter challenges wholesalers to make significant improvements in the coming months and said we will review progress in the autumn. The letter also included examples of the types of issues that would be included in our review.
## Table 3.1 – Key on-going initiatives to resolve market frictions

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
</table>
| **MOSL 2019/20 Market Performance Operating Plan (MPOP)**                   | Sets out two primary objectives:  
  i. the improvement of customer outcomes, and  
  ii. the improvement of trading party performance and accountability  
  It sets out details of four programmes designed to drive delivery of these objectives, including commitments to:  
  • improve the MPF to ensure that the right financial and reputational incentives are in place, and  
  • focus on high quality customer, premises and asset data as well as timely and robust consumption data. |
| **MOSL work to improve transparency and visibility:**                       | **MOSL in 2018:**  
  • published first Annual Market Performance Report (AMPR) which includes league tables of trading parties’ performance against MPF.  
  • Established ‘Market Dashboards’ to track progress on market functioning in number of areas |
| **MOSL Data Improvement Plans (DIPs)**                                      | Following request from MOSL, in 2018 retailers submitted individual Data Improvement Plans (DIPs) to MOSL. The principal aim of these is to reduce the number of meters unread for more than 12 months. |
| **MOSL Initial Performance Rectification Plans (IPRPs)**                    | MOSL in 2018 established *Initial Performance Rectification Plans* (IPRPs) for trading parties whose performance against specific MPS standards is poor relative to their peers. They are intended to help these parties plan and improve performance. From April 2019 onwards IPRPs can also be implemented to address poor performance against specific OPS standards. |
| **Escalation process**                                                      | The Panel is developing an escalation policy intended to allow it to pursue and where necessary, escalate, performance of trading parties against MPS and OPS standards. |
| **Bi-laterals solution**                                                    | MOSL has begun to develop a central bi-laterals solution for the market – that is, a central portal to handle retailer-wholesaler requests. |
| **Retailer – Wholesaler Group (RWG)**                                      | The RWG brings retailers and wholesalers together to tackle key market issues and amend/share good practice to improve overall customer service in the market. Current work includes reducing complexity in bi-lateral interactions, and looking at ways to develop a qualitative measure of retailer satisfaction with wholesaler service. |
4. Conclusions and next steps

Customer awareness of and activity in the second year of the market is broadly unchanged from the first year, with around half of customers (53%) aware of the possibility to choose their retailer and around 13% of customers active in the market since market opening.

Customer savings are also broadly unchanged. We estimate that customers who switched or renegotiated made savings of around £10 million in the second year of the market compared to £8 million in the first year. Levels of customer complaints remain at an unacceptable level, having increased rather than fallen in the second year of the market.

Industry in year 2 has taken some action to start resolving the market frictions we identified in our review of the first year of the market. However - as set out in this report - significant issues remain and we are disappointed with the rate of progress to resolve frictions overall. As the market enters its third year of operation, the sector needs to take urgent action to resolve market frictions swiftly. Otherwise the market will not be able to deliver its full potential for customers. Addressing market frictions should benefit customers who engage in the market (e.g. through greater take up of water efficiency measures) and it should also benefit those who do not engage (e.g. through more accurate billing, which could save them money and time). This will require all industry participants working collaboratively and playing their part.

We are starting to see signs that some industry players are taking action to address frictions in year 3. For example we support MOSL prioritising work this year to improve customer outcomes and hold industry participants to account. We are also seeing some examples of trading parties stepping up to drive improvements – for example the work that the RWG is progressing to develop a common qualitative measure of retailer satisfaction with wholesaler performance.

However, we want to see all industry players step up and play their part in resolving market frictions swiftly.

There are cases where retailers can take further action to support the development of an effective business retail market. For example, as trading parties, they are well placed to identify issues that are contributing to market frictions, but they can also propose solutions to these problems, for instance, by raising Code modifications.

As set out in our recent letter to wholesalers, which made it clear that overall levels of wholesaler support for the development of effective markets was unacceptable, we will be monitoring wholesalers over the next few months and we will review progress in the autumn. If significant progress has not been made by that point, we will consider what further steps to take, bearing in mind the full range of our regulatory tools.
A1 Market developments

Summary

New market entry means that business customers in the second year of the market have a choice of over 20 nationwide retailers. The second year also saw one retailer – Aquaflow – leave the market.

Retailers continue to compete to acquire customers, through a range of price and non-price offers. However, annual switching rates remained broadly static in the second year of the retail market at around 3% (CIS 2019). Renegotiation is an important option for some; around 2% of customers renegotiated a new deal with their existing provider (CIS 2019), compared to around 1-2% last year (CIS 2017 and retailer data).

New entrants have taken around a third of switched supply points in the second year, mainly at the expense of former incumbent retailers. Incumbents have yielded in-area market share to both new entrants and incumbents outside their area, and net losses by incumbents, in terms of the proportion of in-area supply points lost by an incumbent, vary between 4% and 14% (against 3% - 7% net loss at the end of the first year). Nevertheless, overall, incumbents have retained around 98% market share measured by supply point.

Self-supply has continued to grow as a business model - five new self-supply retailers were granted licences in the second year of the market. Self-suppliers overall continue to report advantages of this type of business model, including price savings, better control of their data, and the ability to achieve water efficiency savings. Nevertheless, some have noted difficulties in interacting with wholesalers.

Concerning metering and meter reading services, Ofwat wrote a Letter to wholesalers and retailers about meter reading in the retail market setting out recommendations. In addition, in April 2019 the Retailer – Wholesaler Group (RWG) published guidance on Meter Reading Services - Retailer Information. Concerning entry requirements and credit terms, both Ofwat and the Panel have taken forward work to implement recommendations that we set out in June 2018.

A1.1 Introduction

This section assesses retailer activity in the second year of the market (April 2018 – March 2019), focusing on:

- retailer entry and exit;
- retailer strategies and market offers;
- market share trends;
- self-supply; and
- barriers to entry and expansion.

### A1.2 Retailer entry and exit

The second year of the business retail market has seen three new retailers enter the market (Smarta Water, Utility bidder and Tor Water\(^{26}\)) and one exit (Aquaflow), meaning customers now have a choice of over 20 nationwide retailers. In addition, five organisations have been granted a self-supply licence.

In 2019, Yorkshire Water confirmed its intention to pursue retail exit\(^{27}\). At market opening, Yorkshire Water’s around 140,000 strong group of business customers were transferred to its associated retailers - Yorkshire Water Business Services (YWBS) and Three-Sixty Water. With ‘retail exit’, these customers will be transferred to a separate trading entity.

Yorkshire’s retail exit would be the last former incumbent business retail provider to exit the market. Its exit would also mark one of the main instances of market consolidation in the year; in early 2019, Business Stream announced, subject to regulatory approval, its purchase of the business customer base of YWBS and Three-Sixty. The change is currently planned to take effect on 1st October 2019, leaving Yorkshire with no further business retail market operations.

Figure A1.1 summarises the principal incidences of consolidation in the business retail market.

\(^{26}\) In May 2019 Ofwat issued a Direction to Tor Water. This set out, among other things, Ofwat’s view that at that time Tor Water was not acting as required by the Wholesale-Retail Code. Among other things, the Direction specified that Tor Water must not provide Water Retail Services and/or Sewerage Retail Services to Eligible Premises that it does not already provide these services to while classed as a Defaulting Trading Party.

\(^{27}\) As part of market opening, the Water Act 2014 enabled incumbent water companies in England to decide their participation in the new market. They could continue to act as a retailer within their designated wholesale area – but be unable to act as a business retailer elsewhere. Alternatively, they could choose ‘retail exit’ by transferring their existing business customers to a standalone retail business – such as an ‘associated’ retailer owned by the same parent company, or a third party ‘non-associated’ retailer – and be able to acquire new customers across England and Wales.
In 2018-19, Aquaflow, serving around 75 business customers, became the first retailer to leave the market. Ofwat revoked the company’s licence in March 2019. Using powers under the Interim supply code (ISC), and following a competitive selection process, Ofwat allocated Aquaflow’s customers for transfer to Clear Business Water.
A1.3 Retailer strategies and market offers

The first year of the business retail market saw retailers pursuing a range of customer acquisition strategies, such as:

- more competitive pricing,
- the use of third party intermediaries; and
- cross selling services and focusing on particular customer segments.

Retailers also began, as part of these strategies, to offer a range of service packages to customers, including new services such as consolidated billing, multi-utility services and environmental compliance advice.

These trends have continued into 2018-19. Services, such as consolidated billing and the offer of water efficiency advice and audits, continue to be offered to customers.

Price savings available to customers, compared to default tariffs, have on average fallen to around 2%, against the average of around 3% savings seen in the first year of the market.

One of the key expected benefits of the business retail market was an increased focus on water efficiency. The second year of the market has seen more retailers offer one or more services in this area, particularly in terms of free water efficiency advice or auditing guidance. To a lesser extent, services offered also include more targeted measures such as the development of greywater recycling systems, retrofitting water efficiency devices and also data services, such as benchmarking customer consumption against industry comparators, all of which typically involve costs for the retailer and/or customer. Figure A1.2 below illustrates the extent to which retailers are offering such services, as set out on their websites.

As we set out in section 2 in this report, the take up of such services by switchers and the reported benefits of such services as a result of switching or renegotiating has been slow, particularly among lower consumption customers where annual £ savings from more efficient water usage are likely to be lower.

In their information returns to Ofwat, just over half of retailers (53%) mentioned the cost of providing water efficiency services as a barrier to customer take up of these services. This was more naturally the case for low usage customers, where the cost-benefit case for such services is weaker. Around a fifth (18%) of retailers also mentioned difficulties with automatic meter reading (‘AMR’) provision as a barrier. Figure A1.3 summarises the proportion of retailers citing a number of barriers.

---

28 Research based on review of 21 retailer websites, who together account for almost all (over 99.5%) customer supply points in the market. Note the chart likely under represents incidence of offers of value added services, since some retailers offer such services through the sales process and third party intermediaries rather than directly via their website.
Figure A1.2 – Water efficiency services offered across the market

<table>
<thead>
<tr>
<th>Service</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water auditing</td>
<td>67%</td>
</tr>
<tr>
<td>Automated meter reading</td>
<td>62%</td>
</tr>
<tr>
<td>Leak detection and repair</td>
<td>48%</td>
</tr>
<tr>
<td>Developing a water strategy</td>
<td>33%</td>
</tr>
<tr>
<td>Benchmarking water consumption</td>
<td>33%</td>
</tr>
<tr>
<td>Greywater reuse</td>
<td>29%</td>
</tr>
<tr>
<td>Rain water harvesting</td>
<td>29%</td>
</tr>
<tr>
<td>Retrofit services</td>
<td>29%</td>
</tr>
<tr>
<td>Alternative water sources</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Retailer websites

Figure A1.3 - Proportion of retailers citing barriers to take up of water efficiency services

- Cost: 53%
- Time: 12%
- Not a priority: 12%
- AMR provision: 6%
- No incentive: 6%

Source: Retailer information request
A1.4 Market share trends

This section reviews changes in retailer market shares over the last year, in the context of developments in customer switching. Further data can be found in the interactive statistics function on our website interactive statistics.

There are around 1.2 million eligible business customers in the business retail market in England and Wales. At the end of 2018-19 the total number of supply points (SPIDs) in the market was 2.67 million, and during 2018/19 the total annual clean water consumption by eligible business customers in England and Wales was around 1 million mega litres (Ml) and the total annual wholesale revenue was around £2.5 billion.

Customer switching, as well as changes in retailer market share, has been broadly static, compared to the first year of the market. As set out in section 2 of this report, our CIS 2019 suggested that around 3% of customers switched retailers in the second year, similar to the 3% recorded in the first year. MOSL data suggest customers switched around 4% of supply points in 2018/19, accounting for around 6% of consumption, compared to 5% of supply points and 9% of consumption in 2017/18. Annual switching rates for larger customers remained higher than those for smaller customers; for example the CIS 2019 survey results suggested around 15% of larger customers switched in the last 12 months, compared to around 3% across all customers.

Of the gross gains in supply points in the second year of the market, around two-thirds (65.2%) went to in-area retailers, and around a third (33.3%) went to new entrants (with the remaining 1.5% representing self-suppliers). As such, new entrants have continued to make small net gains in the total market share of SPIDs, consumption and revenue (net gains of +1.3%, +0.8%, and +1.1%, respectively). In contrast, in-area retailers represented 99% of gross losses, while new entrants accounted for only 1%. This is further reflected in the decrease in percentage of customers located in, compared to out, of the in-area retailers’ original incumbent area.

Figure A1.4 sets out the net market share position over the two years of the market.

In the second year of the market, Everflow saw the greatest gain in supply points, consistent with their performance in the first year of the market, with Business Stream ahead in terms of gaining consumption and revenue market share.

Everflow, Business Stream, Clear Business Water and SES Business Water have between them seen the largest net acquisition of supply points. In 2018-19, these four retailers gained just over half (53%) of all (gross) supply point switches. On the other hand, Castle Water, Water Plus and Yorkshire Water led in net losses, accounting for 64% of losses of supply points in 2018/19.
Figure A1.4 – Net market share position

Source: MOSL
Overall, at the end of the second year of the market, the initial in-area retailers remain the largest retailers and retain the majority of the market share – around 97.6% in terms of supply points, across the whole market – figure A1.6 illustrates. Nevertheless, net losses by incumbents, in terms of proportion of in-area supply points lost, vary between 4% and 14% (against 3% - 7% net loss at the end of the first year), with incumbents yielding in-area market share to both new entrants and incumbents outside their area.
**A1.5 Self-supply**

Ofwat licenced five new self-supply retailers during the market’s second year (Blackpool council, British Telecom, Elis/Berendsen, Heineken, Stonegate Pub Company). They joined four self-suppliers who received their licenses in the first year (Coca-cola, Greene King, Marstons, Whitbread). The majority of businesses who have chosen this model to date are large food and drink manufacturers or providers (e.g. Coca-Cola, Heineken). However, more recently interest has emerged from municipal authorities such as Blackpool and Nottingham Councils.

We note that some of the newly-licenced self-suppliers are not yet operating, or have needed time to become active, in the market. One likely factor is the process of becoming a self-supplier, including the switch over and the preparation of supply points. An additional factor may concern self-supplier relationships with wholesalers.

A few self-suppliers have reported facing some issues with wholesalers, including meter reading difficulties and in some cases securing wholesale credit arrangements. In addition, some self-suppliers have reported differences in payment terms and payment timescales between wholesalers, resulting in issues such as wholesaler timescales conflicting with self-suppliers’ internal procedures.
Nevertheless we also note that some self-suppliers have also reported that wholesalers are increasing their efforts to cooperate with and resolve issues experienced by self-suppliers.

### A1.6 Barriers to entry and expansion

*Open for Business* as well as our ongoing market monitoring work identified a number of issues that may be hindering the ability of retailers and self-suppliers to enter or operate in the market. We report on these below.

#### A1.6.1 Metering and meter reading

Our *Open for Business* report (§2.5.3) noted that retailers had raised concerns about meter reading services. We undertook work in summer 2018, including collecting the views of wholesalers and retailers with a view to understanding the potential issues. In their responses, stakeholders identified what they saw as three main problem areas:

- A lack of competitive intensity in the meter reading services market leading to high charges and low service quality;
- Allegations of wholesalers associated with a retailer treating their associated retailer and other retailers on different terms; and
- Inefficient market design on meter reading leading to suboptimal outcomes due to a lack of industry standards, and the onus of meter readings being on retailers and not on wholesalers.

In response to these concerns, in October 2018, we wrote a [Letter to wholesalers and retailers about meter reading in the retail market](#). It set out our recommendations, primarily directed at wholesalers, to improve the meter reading services in the market. We also noted that we would not be taking action using our formal powers at that time, and that we would look to engage with the sector around meter reading again after stakeholders have had a reasonable opportunity to consider, and act on, our recommendations.

Since October 2018, retailers and wholesalers have taken their work forward through the Retailer – Wholesaler Group (RWG). In April 2019, RWG published guidance on [Meter Reading Services - Retailer Information](#). It provides a centralised location where retailers can easily identify Wholesalers who offer a Meter Reading Service within their respective wholesale area.

We will be monitoring developments and progress on metering and meter reading during the third year of the market’s operation.
A1.6.2 Entry requirements and credit terms

_Open for business_ (§2.5.2) set out that some new entrants have suggested that entry requirements and credit terms may act as a barrier to entry. In particular, some expressed the view that credit requirements for market entry are more stringent and costly for new entrants than initial in-area retailers. As noted above, some self-suppliers have also raised concerns about securing credit terms with wholesalers, which are necessary to operate in the market.

As we set out in _Open for business_, in light of these concerns we carried out our review of credit term arrangements, published in June 2018, which made recommendations that should facilitate processes for obtaining required credit arrangements. Since then, both we and the Panel have progressed work to implement these recommendations, in particular:

- The Panel, working via the Credit Committee, have made a number of recommendations for code modifications to improve and/or clarify the existing credit arrangements.
- In December 2018, Ofwat approved a code modification that allows trading parties to negotiate and agree bespoke payment terms outside the terms prescribed within the market codes. This code modification provides an additional and more flexible option for payment terms for both existing and new market entrants. We think that this flexibility provides trading parties, in particular retailers, with an opportunity to propose innovative payment terms and offer customers more flexible terms of payment. This has the potential to mitigate the impact of such financing requirements on new entrants’ business models.
A2 Market performance framework

This annex sets out summary metrics of wholesaler and retailer performance under the Market Performance Framework described in section 3.

Figure A2.1: MPS performance by wholesaler – 2017/18 vs 2018/19

Source: MOSL
Figure A2.2: MPS fees per wholesaler 2018/19 – uncapped – £/10,000 SPIDs

Source: MOSL
### Figure A2.3: MPS performance by retailers with more than 5,000 SPIDs – 2017/18 vs 2018/19

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Water2business</td>
<td>88%</td>
<td>12%</td>
<td>81%</td>
<td>19%</td>
<td>-7%</td>
</tr>
<tr>
<td>Affinity for Business</td>
<td>88%</td>
<td>12%</td>
<td>87%</td>
<td>13%</td>
<td>-5%</td>
</tr>
<tr>
<td>Yorkshire Water</td>
<td>91%</td>
<td>9%</td>
<td>96%</td>
<td>4%</td>
<td>-8%</td>
</tr>
<tr>
<td>Clear Business Water</td>
<td>76%</td>
<td>24%</td>
<td>84%</td>
<td>16%</td>
<td>-8%</td>
</tr>
<tr>
<td>Wave</td>
<td>75%</td>
<td>25%</td>
<td>84%</td>
<td>16%</td>
<td>-9%</td>
</tr>
<tr>
<td>Castle Water</td>
<td>61%</td>
<td>39%</td>
<td>78%</td>
<td>22%</td>
<td>-18%</td>
</tr>
<tr>
<td>Water Plus</td>
<td>73%</td>
<td>27%</td>
<td>91%</td>
<td>9%</td>
<td>-19%</td>
</tr>
<tr>
<td>Pennon Water Services</td>
<td>77%</td>
<td>39%</td>
<td>96%</td>
<td>4%</td>
<td>-19%</td>
</tr>
<tr>
<td>Everflow</td>
<td>76%</td>
<td>24%</td>
<td>95%</td>
<td>5%</td>
<td>-19%</td>
</tr>
<tr>
<td>SES Business Water</td>
<td>55%</td>
<td>45%</td>
<td>75%</td>
<td>25%</td>
<td>-22%</td>
</tr>
<tr>
<td>Business Stream</td>
<td>67%</td>
<td>33%</td>
<td>89%</td>
<td>11%</td>
<td>-13%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>75%</td>
<td>25%</td>
<td>89%</td>
<td>11%</td>
<td>-13%</td>
</tr>
</tbody>
</table>

Source: MOSL
Figure A2.4: MPS fees per retailer 2018/19 - uncapped – £/10,000 SPIDs

Source: MOSL
State of the Market: reviewing the second year of the business retail market

Figure A2.5: OPS performance by wholesaler 2018/19

Source: MOSL, Ofwat analysis.

Note Ofwat has prepared the chart in figure A2.5 on the following basis:

A = Number of tasks completed within reporting period
B = Number of tasks outstanding at end of reporting period outside time permitted
C = Number of tasks completed within time permitted

with:

Percentage of tasks completed on time = C÷(A+B) x 100
Percentage of tasks completed late = (A-C)÷(A+B) x 100
Percentage of tasks outstanding that should have been completed in reporting period = B÷(A+B) x 100

MOSL in table 5 of its Annual Market Performance Report has set out an annual summary of OPS performance amongst wholesalers. This ranks performance measured as the ratio of the number of tasks completed within time permitted (ie. C) to the number of tasks completed within the reporting period (ie. A). Note that the performance metric there can be reproduced from the above chart, as:

= % tasks completed on time ÷ (% tasks completed on time + % tasks completed late)

Ranking of performance on this basis will produce a different ranking to that given in figure A2.5 above.
A3 Regulatory developments in customer protections

A3.1 Introduction

Business customers that have not actively engaged in the market continue to be served by a retailer, but are served on the basis of a ‘deemed contract’, including default tariffs. In order to protect these customers, Ofwat has put in place the Retail Exit Code (REC) which contains protections over the price and non-price terms that can be placed in deemed contracts. Alongside this State of the Market report, Ofwat has published its decision on the nature of these price and non-price protections that will apply from April 2020.

A3.2 REC Price protections

The current price protections are linked to a price control that is due to expire at the end of March 2020. We have been considering the protections that should apply after this date and have now issued our decision on the price protections that will apply from April 2020. We have carefully considered our duty to protect the interests of customers, wherever appropriate by promoting effective competition. On balance we believe it is appropriate at this point in time - while the market frictions are being resolved and the effectiveness of the market continues to develop - to retain protections for lower usage customers who have not yet engaged in the market. So for customers on deemed contracts who use less than 0.5Ml per year we are retaining price protections at a similar level to the current protections. For higher usage customers, who are more likely to engage in and benefit from the market, we believe it is possible to put a greater focus on the promotion of effective competition to protect customers’ interests. So from April 2020 for customers on deemed contracts who use more than 0.5Ml per year we are retaining but relaxing price protections. We intend to revisit the price protections in two to three years.

A3.3 REC Non-price protections

We are also strengthening non-price protections for customers who have not engaged in the market in relation to their non-price contract terms. We are introducing an explicit ‘no worse off’ principle to apply to deemed contracts from April 2020 onwards. Where retailers wish to make changes to their non-price terms relative to those at market opening, they will need to be able to demonstrate that their customers will be no worse off as a result. This approach strikes a balance between ensuring that customers who have not engaged in the market are protected but in a way which allows retailers some flexibility to improve their service, offering or operations.
Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.