The background features a large, stylized white arrow pointing to the right, set against a blurred image of a modern building with a glass facade and a large, glowing light fixture. The overall color palette is light and airy, with soft blues and whites.

# Retail Energy and Behavioural Economics

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## Retail Energy and Behavioural Economics

- Behavioural issues are at the heart of competition concerns in retail energy markets
- Features of the market make retail energy particularly susceptible to behavioural biases
- Many of the remedies in the Probe and RMR are behavioural in nature

## Retail Energy and Behavioural Economics

- Motivation and Engagement
  - What makes consumers even think about changing supplier?
  - What factors stop them engaging once they do?
- Search and Selection (*Access and Assess*)
  - Once consumers decide to engage, what obstacles do they face in finding the right deal?
- Fulfilment (*Act*)

## Economistic model of motivation

- The default mode of behaviour is that consumers are motivated to seek out incremental improvements in welfare
  - Consumers continuously monitor the market and are aware of alternative offers and how they compare with their current arrangements
  - Consumers will notice “money on the table” and will be motivated to act to improve circumstances
- Failure to do this is a “revealed preference”, suggesting the transaction costs, or value of “loyalty” exceeds the benefit
- “Behavioural biases” that might impact motivation include
  - Inattention and distraction
  - Status Quo bias
  - Loss aversion

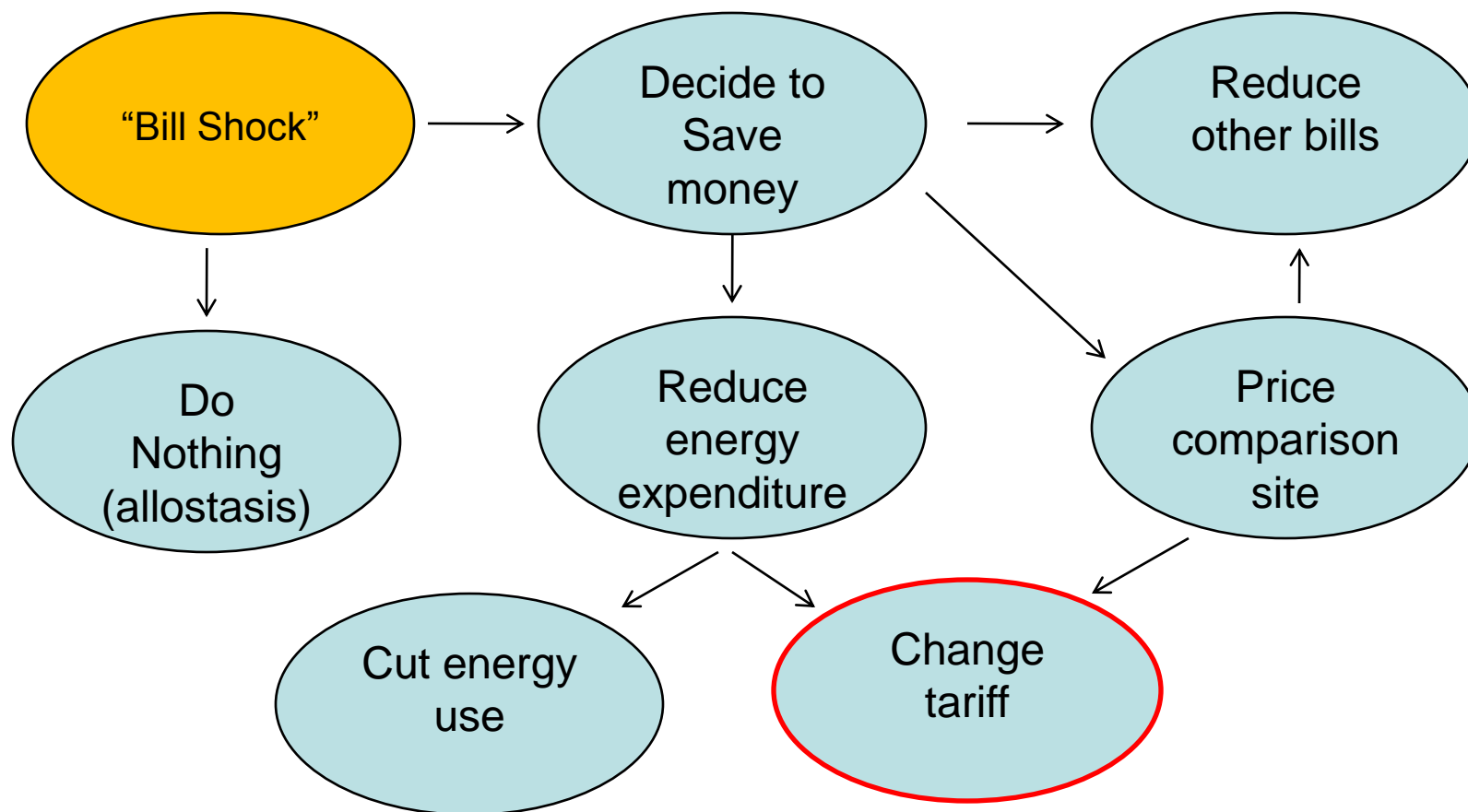
## Behavioural model of motivation

- People act to preserve a stable equilibrium in their circumstances (homeostasis)
- Well being is driven as much (or more) by stability as it is by improved circumstances
- People adapt over time to (positive and negative) changes in circumstances, and satisfaction generally returns to a inherent norm (allostasis)
- A decision to act is the exception rather than the rule, will be driven by threats to the equilibrium
- Reward or novelty seeking behaviour operates within this context
- Status quo bias, loss aversion and inattention are rational reflections of this preference for homeostasis

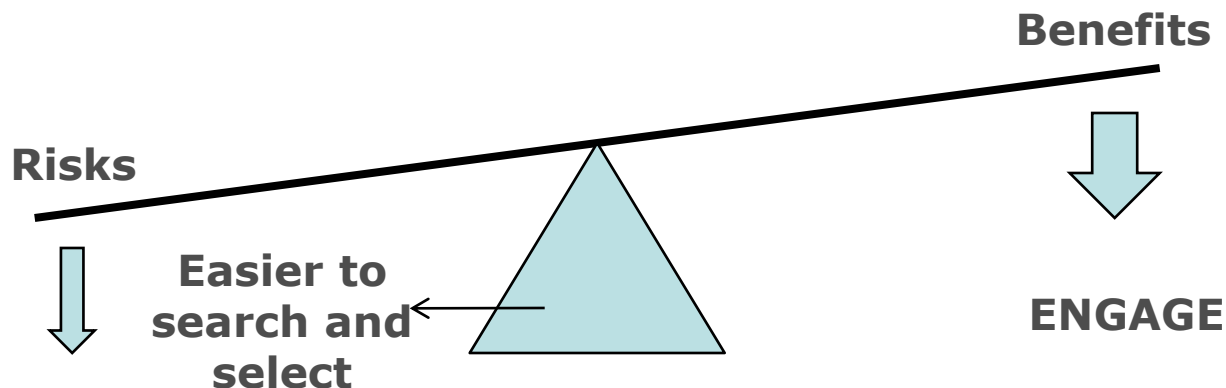
## “Triggers” for retail energy consumers

- Regular “good housekeeping”/ end of contract
- General budget pressures
- A shock – a large bill, a price rise, DD rise
- Friends and family
- Poor customer service experience
- Change of tenancy
- Response to advertisement (supplier/ comparison site)
- Approach from a sales agent

## Motive to Engagement



## Turning motivation into engagement



- Policy interventions to increase engagement of *motivated* consumers should address real and perceived risks, benefits and obstacles
- Consumers trust in the market and confidence in their ability to navigate it are at the heart of this challenge



## Engagement – consumer perspectives

- Overwhelming majority of engagement is through supplier sales activities
- Research suggests perhaps a fifth engage through own efforts each year
- Most switchers are motivated to save money, but not exclusively
- Most who do not engage are “happy as they are”
- Many do not believe the benefits of switching and are deterred by risks

## How Ofgem is addressing engagement issues

- By seeking to increase consumer **confidence and trust**
- Strengthening **prompts** to engagement
- Making the market **easier to navigate**
- Promoting effective use of **intermediaries**
- Promoting **smarter markets**

## Product features that hamper search and selection

- The large number of different tariffs
- Inconsistent or misleading terminology and presentation
- Restricted availability “loss leaders”
- Complex and contingent discount structures
- Two tier “no standing charge” tariffs (plus sculpting)
- Acquisition/ win-back offers and incentives
- Non-price features

**MANY SUPPLIERS HAVE MADE CHANGES TO ADDRESS THESE ISSUES**

## Search and Selection

- Consumers have three realistic options for search and selection in the current retail energy market
  1. Get some help
  2. Incomplete search and selection and
  3. “Bounded rationality” methods
- Each carries risks for consumers in the current market, and are exploited by suppliers

## Search and selection - some facts

### Incomplete search, imperfect selection

- 50% of switchers only consider one alternative to their current supplier (68%)
- 6% do a partial search by phoning suppliers or searching supplier websites (3%)
- 5% act on recommendations of friends and family (5%)
- 36% use a price comparison service (22%)

2011 data for electricity switchers. (2008 in brackets)

*Switching rate was 14% in 2011 and 19% in 2008*

## Ofgem's options

- Leave it to competition and market processes
- Prohibit obviously unhelpful or misleading behaviours
- Radical reduction in range and complexity of products?
- Radical improvements in provision of tailored information
- Broaden the reach of intermediaries

**THESE OPTIONS ARE AT THE HEART OF THE DEBATE ON RMR**

# FINAL THOUGHTS

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

*ofgem*

Promoting choice and value  
for all gas and electricity customers