

Tariff simplification

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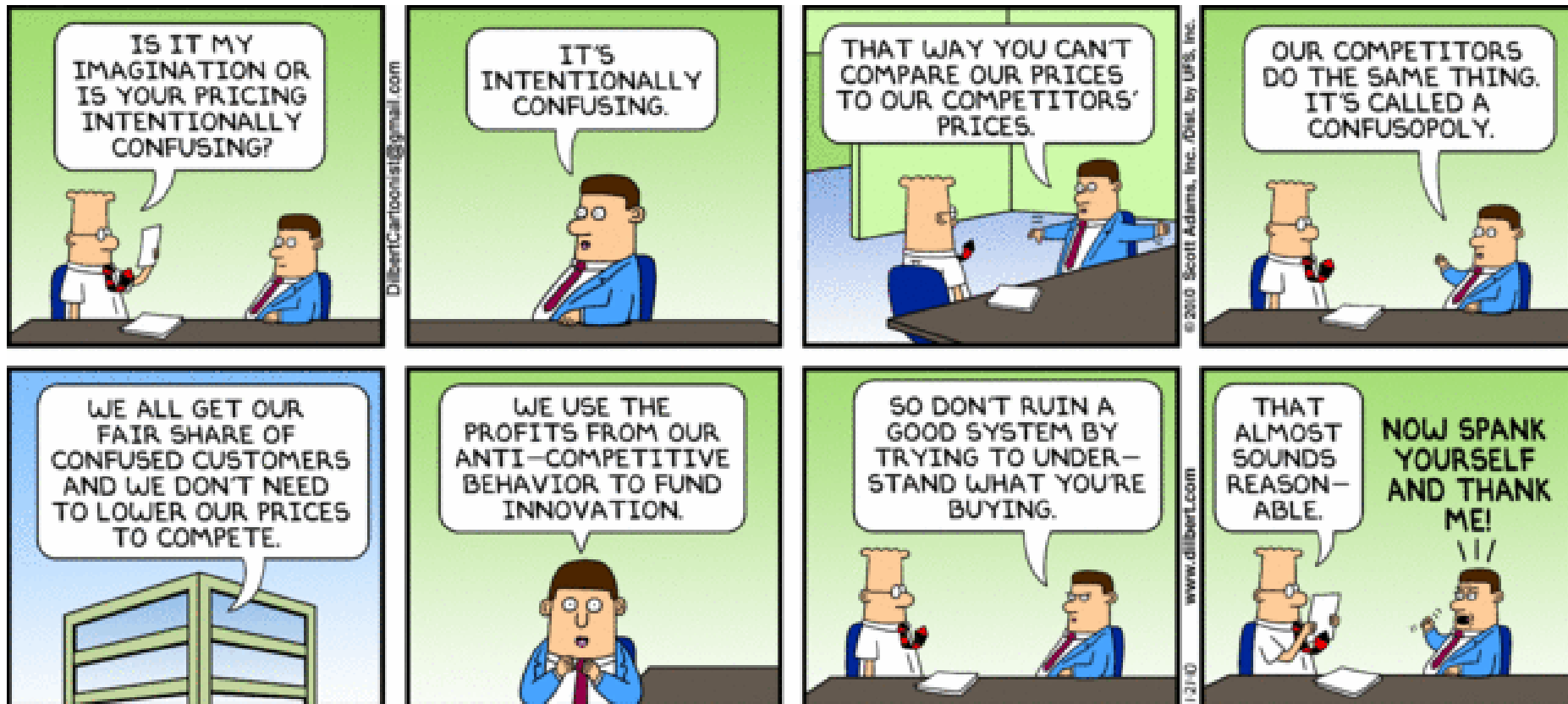
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Tariff simplification

- ✦ It's in fashion....
- ✦ Intuition
- ✦ Empirical evidence on switching
- ✦ Policy implications

Do companies deliberately obfuscate?



Regulators keen to simplify

Ofgem: Simpler choices

Four core tariffs for gas and electricity from each supplier, a single standing charge, advanced notice of when your fixed deal ends and more. (Ofgem website)

We're calling for cheaper, fairer and simpler train fares. (campaign for better transport)

FCA urges simplification of fund charges (FT 14.05.14)

Intuition: Demand side

Need active consumers to make market work

Sticky customers –say they are confused

Reducing confusion will remove a barrier so more activity

Are there other barriers?

Attention

Confidence – related to confusion, but may be more complicated

What really ‘activates’ consumers?

Companies agree on and target 'active' group

Companies likely to charge high/low prices to similar customers: low prices to the active, price responsive
high prices to 'sticky', least price responsive

Simplification unites prices charged to different groups of customers

In this case, simplified tariffs will be 'in the middle'

The constrained price will be between the other two

Immediately: passive consumers benefit, active pay more
(see good deals disappearing)

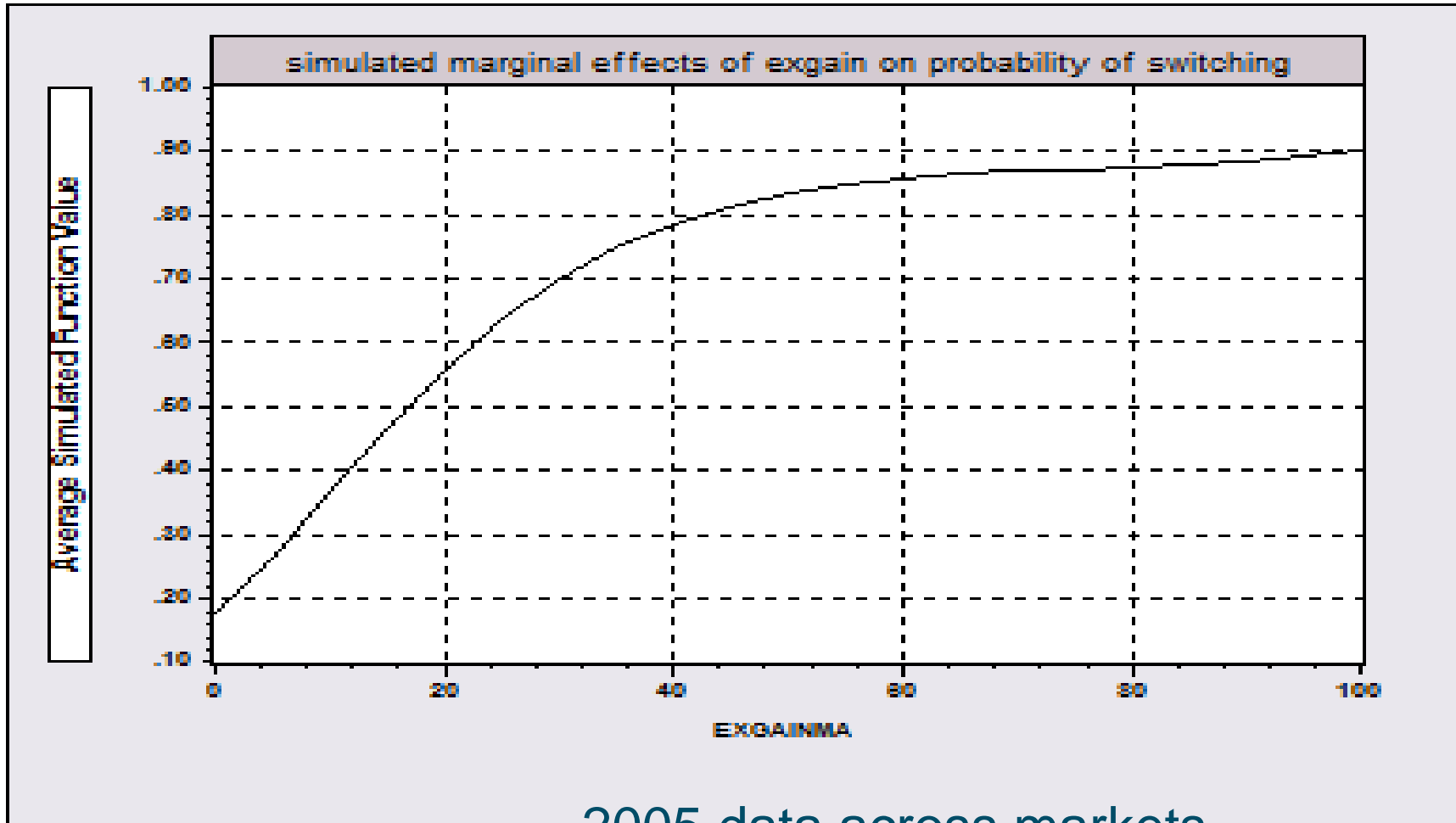
Raises total, distributional welfare issues

Potential gains from switching will fall for inactive:

Gains for both groups from switching to cheaper **supplier**
but none from switching to cheaper **tariff type**

Switching rates will fall in this market, and perhaps others,
because

Gains drive consumer switching



2005 data across markets

Gains consistently important, but influence varies

- ✦ ... from **surveys** across markets (2005), electricity (2010), & **observation** of collective switching (2012)
- ✦ Increased (expected or offered) gain increases switching
- ✦ Confidence in gain important (2010, 2012)
- ✦ Varies in effect: incentivises searching for the less active/more time constrained (not regular searchers)
- ✦ Incentivises switching for all, especially the most active group (as expected)
- ✦ Increases likelihood of accepting collective switch offer

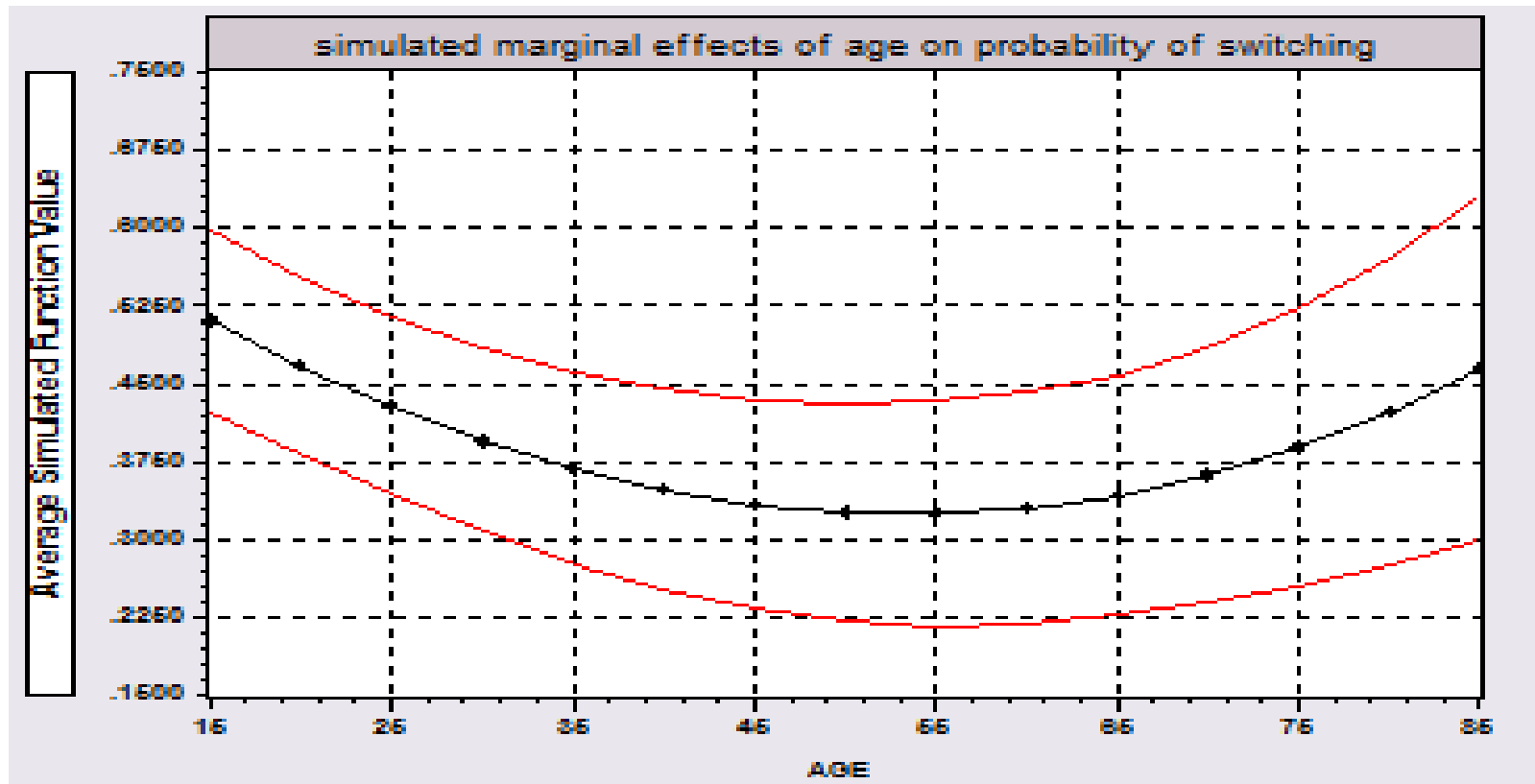
Lower searching time may not encourage more activity

- ✦ Neither 2005 nor 2010 respondents deterred by expected search time
but active subset who could give expectations of gain/time
- ✦ Confusopoly may have been less of a barrier for this group
- ✦ no search for collective switch - treat as a pure switch decision –untypically active group

Switching time deterred activity

- ✦ for 2005 group (search and switching)
not 2010 (attitudes more important)
- ✦ Variation across markets
- ✦ more likely to switch if have done so in another market
- ✦ Pure switching costs in collective switch:
 - ✦ only about one third of those who could gain
 - ✦ Median savings £106 per year, around 10% of bill

Those 'of pensionable age' more active than the middle aged



Who else is active? (controlling for other variables)

- ✦ Lower income more active (2005);
and those who felt better off least active (2010)
- ✦ Education little effect
- ✦ Females more active 2005, males in 2010, 2012
- ✦ Those who saw 2 rather than 1 offer in collective switch
less likely to change – particular to group & circumstances?

Many 'vulnerable' consumers had switched electricity, even in 2005

Vulnerable group	Incumbent	Switched
Over 65	46	54
Low income	47	53
Disabled	44	56
Rural	60*	40
Low educational attainment	52*	48
At least one	47*	53*
<i>All consumers</i>	42	58

*Significantly different from non vulnerable at 1%

Policy Implications

- ✦ Inactive gain, active lose from simplification
- ✦ Net gain depends on size & demand response of each group
- ✦ Harms all active, including members of 'vulnerable' groups
- ✦ Fewer gains and less switching among the less active
 - ✦ but may improve quality of decisions – effect on offers?
- ✦ Careful monitoring & more research needed, particularly amongst the less active.