

Mapping customer requirements and behaviours in retail energy and financial services: what differs?

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Disclaimer/Disclosures



George's exam question(s)

Q1: What can be learned from comparisons between information processing systems/structures adopted in different economic contexts?

A1: A lot

Q2: Mapping customer requirements and behaviours in retail energy and retail financial services: what differs?

A2: Very little

Three key ideas to explore...

1. The **framework** used by most regulators and CMA is **wrong and doomed to failure**
2. What **we don't know** about how competitive markets with high customer activity **really work** in a **digital world** might make us rethink how 'fair' certain problem markets are
3. Left to their own devices **markets can and will solve** these problems but probably **politically infeasible** as this will take time and there will be bumps in the road...

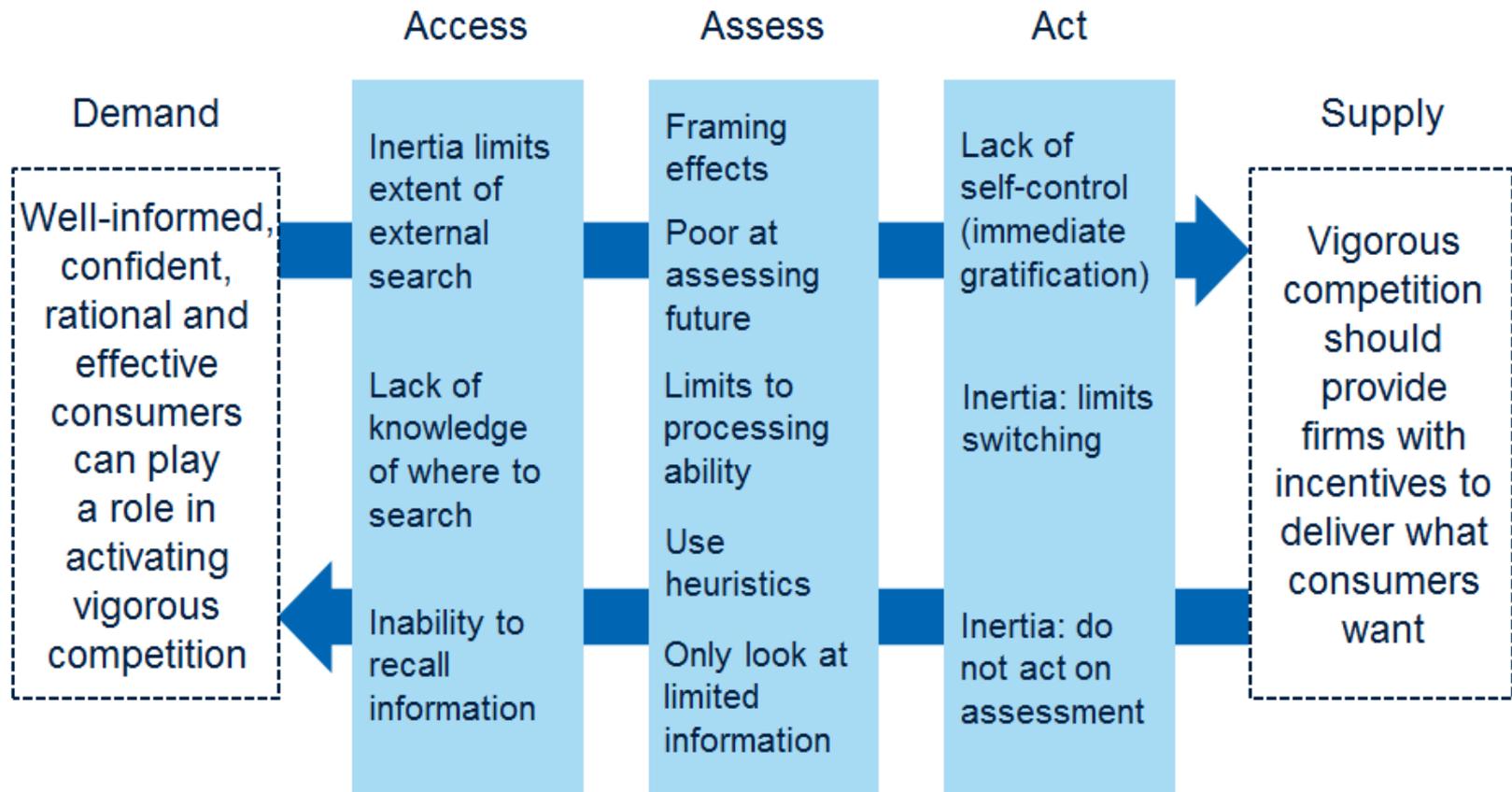
Regulators (and consumer groups) can **inflame** and **amplify** concerns or can **work with** the grain of **the market** to deliver **better outcomes** for customers and **accelerate** the **market response** whilst mitigating pressure for overt and damaging political intervention

The conventional wisdom?

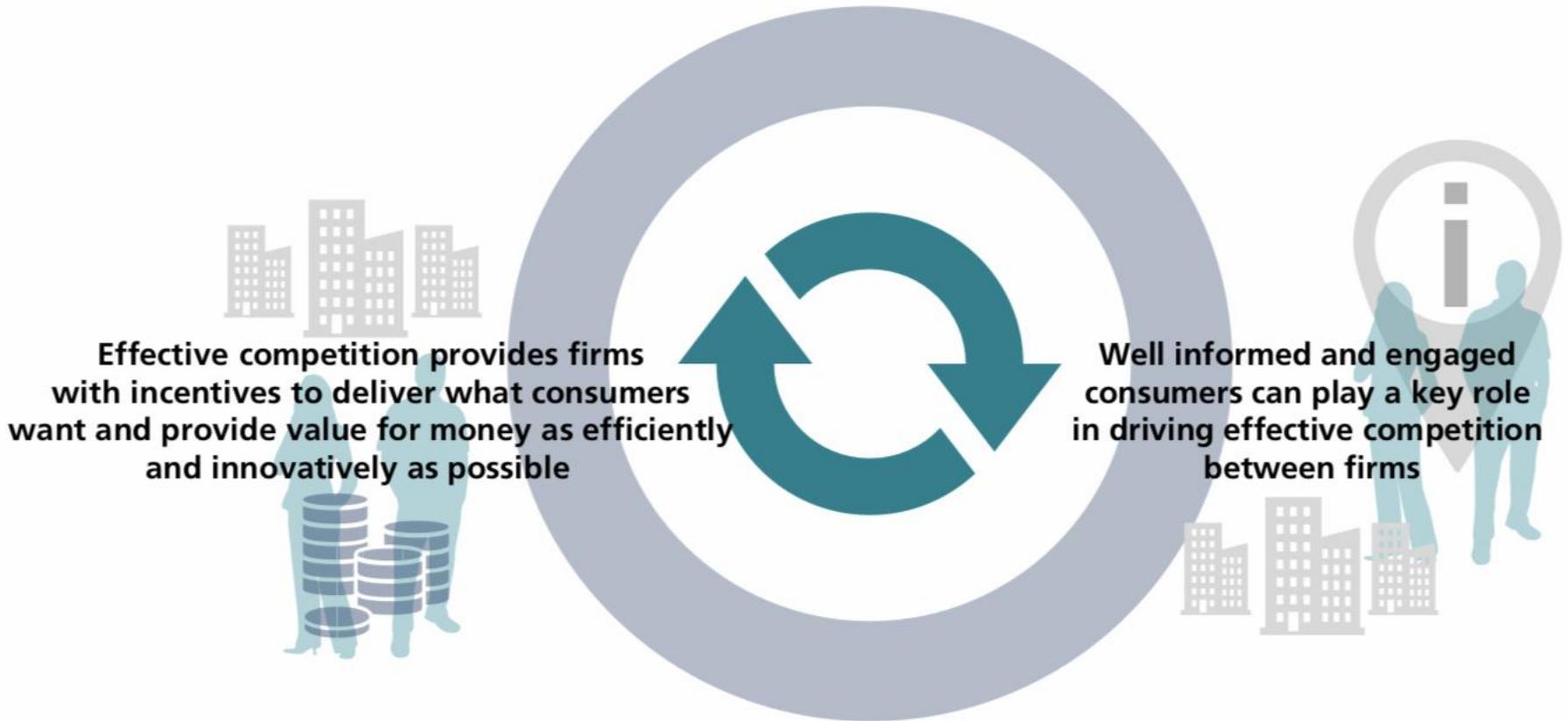
1. *Convergence of thinking/framework from competition authorities and sector regulators: the **Access/Assess/Act** framework with a dash of **behavioural economics** to drive remedies and nudge customers*
2. *Creates virtuous circle: **lower prices, fairer prices, better distributional outcomes***
3. *Overemphasis on **switching** rates – creating a focal point – make it easier to switch then use behavioural nudges to drive ever more customers to engage*
4. *Naïve analysis of **gains from switching** – creates **easy headlines** for journalists and politicians establishing narrative of “**rip off**” and “**excess profits**”*

Political reality then bites: politically imposed price controls e.g. payday loans and retail energy bypassing (and undermining) the institutional process (CMA) – this is a very bad outcome for customers and the institutional framework

The framework underpinning (I)



The framework underpinning (II)...



What's wrong with the theory (I) ?

Supply Side

1. *Digital, (big) data and **shrouded price discrimination***
2. *Assumption or findings of **excess profit** when reality is **distributional effects** that dominate*
3. *Compounded by **failure** to **analyse** properly policy **subsidies** to new entrants (energy) and/or sustainability of **new entrant price benchmarks** (financial services)*

More customer activity leads to more extreme price discrimination and smaller numbers of customers paying much higher prices. The 'problem' of unfair pricing gets worse not better...

What's wrong with the theory (II) ?

Demand side

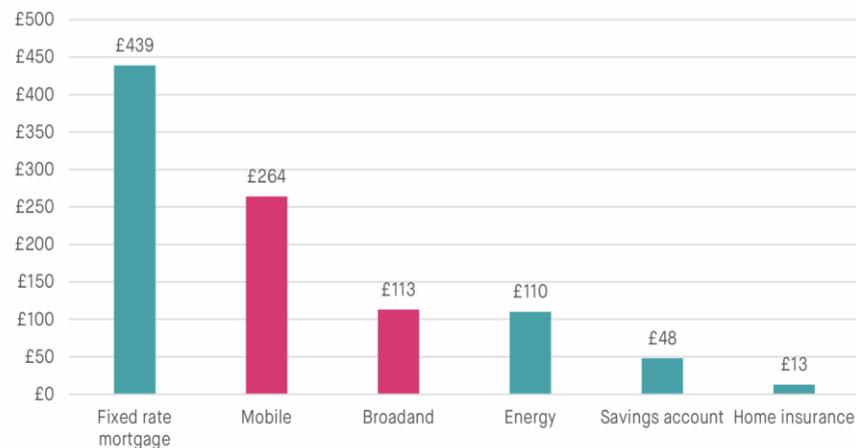
1. *Cognitive load on consumers of AAA*
2. *Smith's "Quantitative theory of limits to nudging"*
3. ***CMA consumer advice*** – *shop around using several comparison sites: do the maths: energy, mobile, broadband, home and motor insurance, mortgage, savings, current account....*

Or more simply people lead busy lives and simply have better things to do...

What really matters to households and where are the biggest gains?



Figure 11: Annual loyalty penalty, 2017



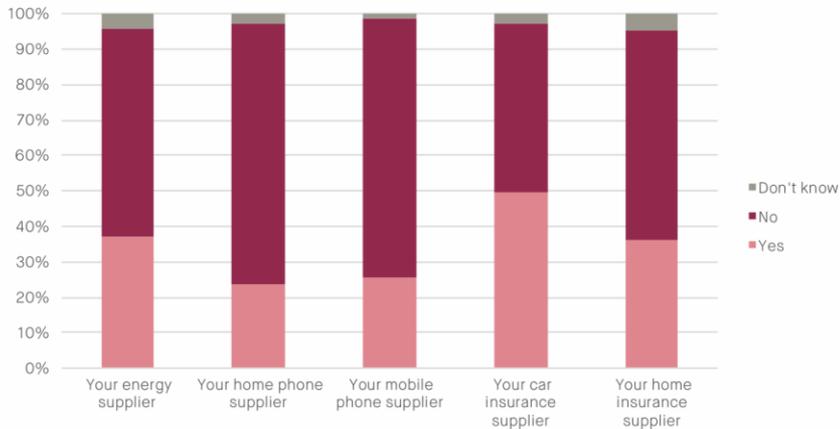
Source: Citizens Advice

Framing of problem dictates media coverage, politics and degree of regulatory scrutiny and demand for action..

Doesn't lead to action where problems (and consumer gains) are most significant?

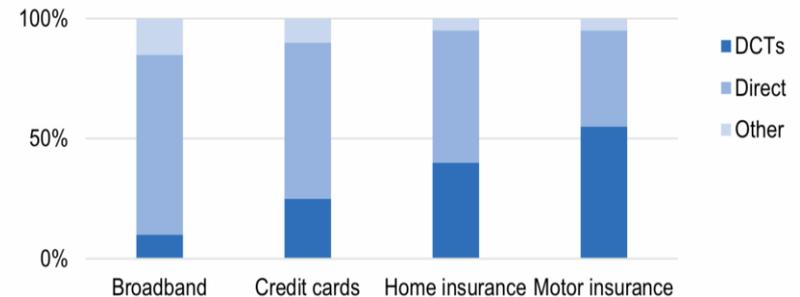
Lack of understanding of how digital markets with engaged customers really work....

Figure 1: Have you switched any of the following in the past 3 years?



Source: Populus Survey for the SMF, excludes those respondents whom say 'not applicable'

Figure 3.2: The significance of DCTs as a sales channel in terms of sales volumes in 2013-2015

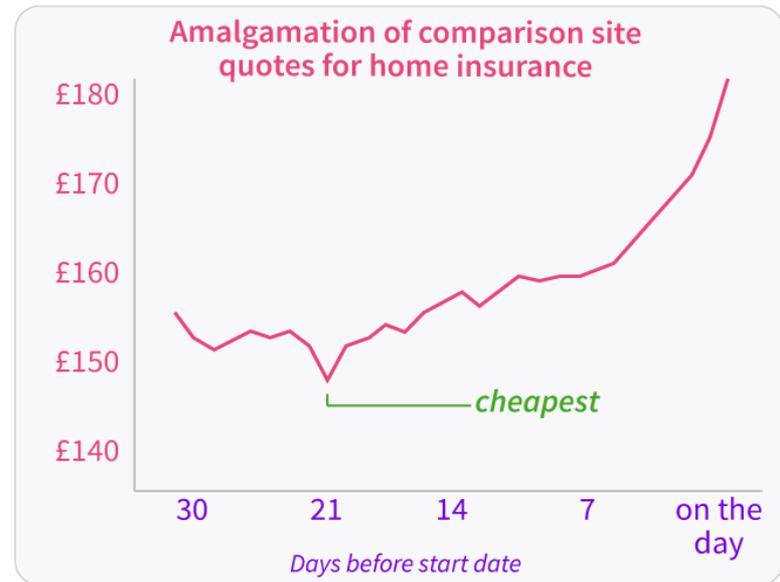
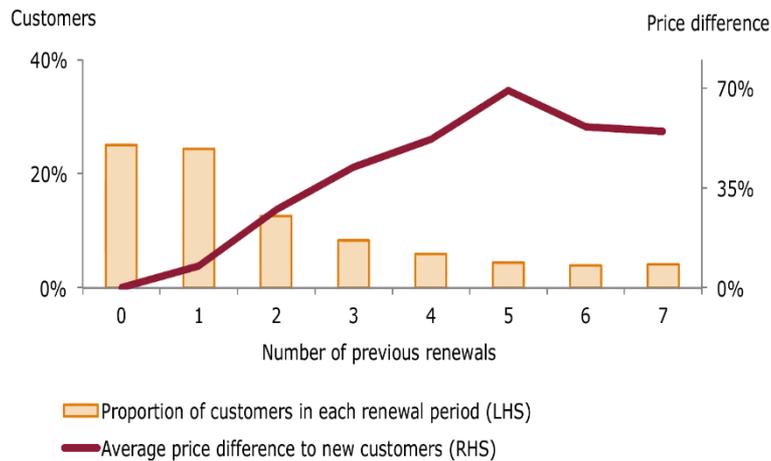


Source: CMA analysis of data received from suppliers and information from the Private Motor Insurance (PMI) report. Note: CMA analysis for broadband, credit cards and home insurance is based on a simple average of supplier acquisition channels for new business (four suppliers in broadband, six suppliers in credit cards and nine suppliers in home insurance). Each channel is rounded to the nearest 5%. Suppliers provided the proportion of new customers acquired by different channels. The data has not been weighted by volume or revenue and relates to a small number of large suppliers which list on DCTs. The analysis for motor insurance comes from the PMI market investigation.

Insurance markets have some of highest levels of switching and most penetrated by price comparison websites...

But pricing outcomes are more pronounced and more complex than energy

Figure 2: Home renewal discount structure (average of three firms)



Motor insurance even more stark: 30 days c£500 more expensive than 21 days and on the day c£570 more expensive

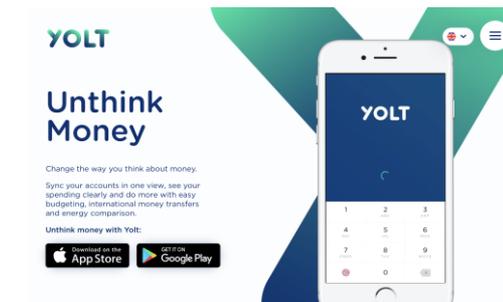
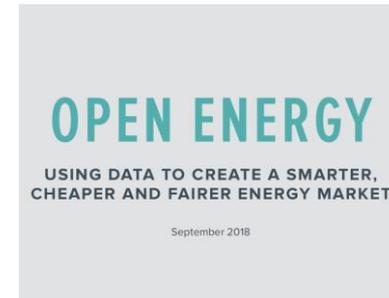
How markets respond and how digital helps...

Physical intermediaries	Digital Intermediaries	Digital Auto switch
<ul style="list-style-type: none">• Middleman economy• Mortgage brokers 70% of all mortgages in UK• Can be commission based (eg mortgages) or fee based (financial advice)• Advice provided but final choice rests with customer	<ul style="list-style-type: none">• Price Comparison websites/collective switching• High and growing penetration of many markets• Commission based• Customer must choose intermediary and product/service provider	<ul style="list-style-type: none">• Emerging in energy and other sectors• Some commission based/some fee based• Customer can set limits but delegates some authority to service

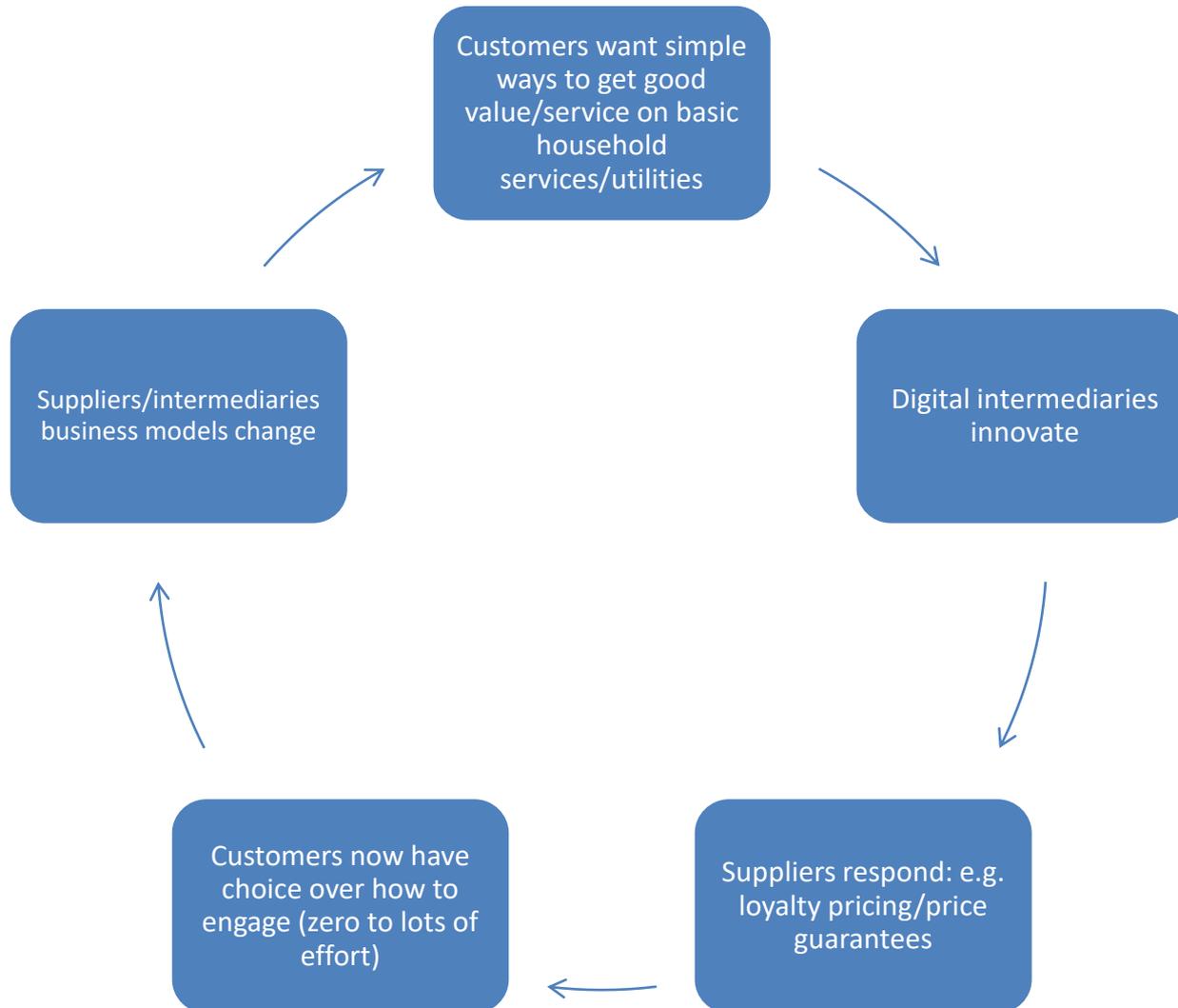
Ease and speed of use drive customer take up – models continue to evolve but diverse from small start ups to £bn businesses

Open data can accelerate this market response...

1. What is it and why does it matter?
 - a. Data standards and APIs – allowing secure sharing of customer data with consent (consumption, supplier, tariff information)
2. Allows instant and personalised product comparison but also behavioural (FS now and energy in future?)
3. Live in FS, energy summer 2019, telecoms and other sectors should follow quickly

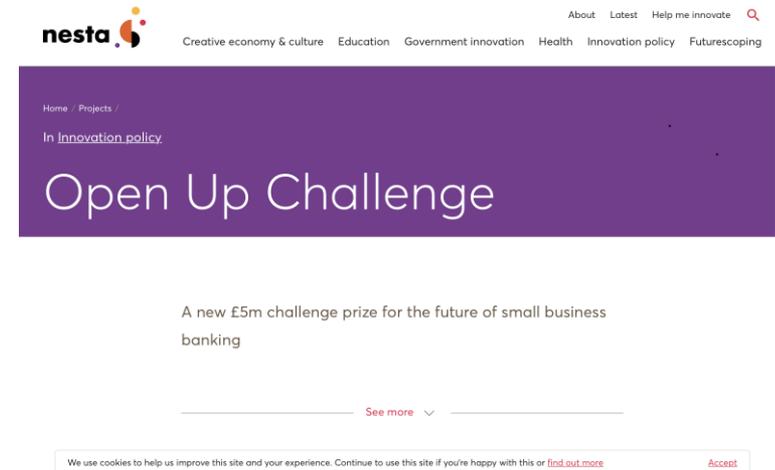


A different virtuous circle...



Supported by the use of prize funds

1. More use of innovation prizes...
2. To accelerate solutions to problems eg those vulnerable segments not participating in digital solutions
3. Ex post not ex ante (open and not closed)



Conclusions

1. Current approach will lead to **more political intervention**, price caps, behavioural remedies that damage innovation and **harm customers over time** and **undermine institutions**
2. Regulators need to **take the sting out** of the political debate with better, more robust analysis of markets and not create easy headlines and **wrong focal points**
3. **New framework** that uses **opening up data** to create a new **virtuous circle** that doesn't make unrealistic demands on customers
4. Over time this should see **changes** in **supplier behaviour** and **business models** as they respond to rise of intermediaries
5. Tackle head on any **digital divide** – with some politically sensitive/vulnerable customer groups being left behind – use **prize funds** to drive **rapid innovation** for these groups working with the market