

DO VICTORIA'S HOUSEHOLDS LEAVE LESS MONEY ON THE TABLE WHEN THEY SWITCH ELECTRICITY RETAILERS?

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Overview

Governments, regulators and customer groups in Australia have urged retail electricity customers to switch retailers to get better deals. Customers have responded and switching rates are high. A common view is that over almost a decade of unregulated competition a two-tier market has evolved, in which “switchers” avoid the “loyalty tax” paid by “remainers”. We refer to this as the “bifurcation hypothesis”.

We analyse a little over 48,000 Victorian household electricity bills to compare outcomes for switchers and remainers. The typical remainder left \$281 per year (20% of their bill) on the table. However, after controlling for various factors, switchers only leave \$45 less on the table. This calls into question the common view of a market bifurcated between switchers and remainers. Competing explanations include that customers value attributes other than prices when they search and switch, that rents have already been competed away, that customers find tariff structures and discounts confusing or that they get poor advice. We conclude that customers mostly search for lower prices, that rents have not been competed away and that tariff structure complexity does not seem to be a problem. Discounts that are not as they seem and poor advice from price comparison service providers likely explains part of the market's failure to give most customers what they seem to be searching for. While successful retail markets may depend on demand-side participation, this is not sufficient. Customers must be able to participate effectively if they are to benefit from the market.

Methods

We use contemporary data science techniques to extract relevant data (such as usage, discounts, cost) from a little over 48,000 individual residential electricity bills uploaded by households to the Government's price comparison website between July and December 2018. The bills are compared to all publicly available market offers to establish the “money left on the table” (MLT) of each bill. MLT is the gap between the estimated annual bill based on the customers' actual prices and the annual bill they would pay if they had been able to select the best offer in the market. Parametric (OLS) and non-parametric (Multivariate Adaptive Regression Splines) methods are used to isolate the effect of switching on MLT.

Results

After controlling for various factors, the typical (median) remainder has an MLT of \$281 per year (around 20% of their bill). By contrast, the median switcher has an MLT of \$236 per year. The difference in the MLT of switchers and remainers is \$45.

Conclusions

In his critique of retail electricity markets (Defeuilley, 2009) focussed on the complexity of the determinants of choice and suggested this would explain why many customers would avoid switching even if they would gain from it. He suggested that would translate into persistent segmentation between active and inactive customers. While active customers would benefit from competition, weak price competition for inactive customers would give market power to the incumbent retailer over the customer (i.e. the “bifurcation” hypothesis).

Analysing a little over 48,000 household electricity bills, we test for evidence of the bifurcation hypothesis in the Victorian market. Our main finding is that after controlling for various factors, switchers only leave \$45 per year less on the table than remainers. This casts doubt on the common understanding that the retail market bifurcates between switchers (who get much better deals) than remainers. This is not necessarily inconsistent with the

proposition (which we could not test) that a subset of switchers consistently gets better deals than remainers (and other switchers). While we think our sample may be biased towards more engaged customers, we do not think this bias is likely to be large and so the conclusions from our sample are likely to be representative of the population.

Encouraging customers to switch retailers has been the mainstay of policy makers' response to customers' concerns about the retail market. Customers have responded to the encouragement to engage, but evidently many are not getting the results that they and policy makers are seeking. Policy could be refocussed to promote effective participation by the demand side. Improving price comparison services would be valuable. Comparing the comparers and/or regulating comparison methods such as has long been the case in Great Britain for example, merits consideration. Alternatively, providing an easy way for customers to know when they are getting bad advice might be considered.

References (selected)

Defeuilley, C. (2009) 'Retail competition in electricity markets', *Energy Policy*, 37(2), pp. 377–386. doi: 10.1016/j.enpol.2008.07.025.

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