Switching Energy Suppliers: It's Not All About the Money

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BACKGROUND

- The UK government has promised intervention in the energy market in response to evidence that many consumers are not taking advantage of the potential savings from switching supplier, and so apparently paying 'over the odds'.
- Liberalised retail energy markets present an apparent puzzle: when offered the chance to buy a homogeneous product at a lower price, many consumers appear to leave 'money on the table'. This is a particular conundrum since energy costs constitute a significant proportion of household energy expenditure.
- We study an opt-in collective switch, called 'The Big Switch' (TBS), where participants had to exert minimal effort to complete a switch once presented with their offer. Yet only just over a quarter of those who were offered positive savings took the small step necessary to accept the offer.
- Even for savings of over £300 per year (around a third of the average bill), fewer than half switched, despite the fact that these participants had already actively opted in to the auction, faced no additional search costs and often had characteristics usually associated with market engagement.

METHODOLOGY

- The offers made to more than seven thousand consumers, and a record of their actions, were combined with survey data about their attitudes and circumstances.
- Since the 'search' process of finding a better deal was performed by the auction process itself, we are able to identify pure switching costs.
- We use a probit model to identify the factors associated with accepting an offer including the potential savings offered, the presence of exit fees, non-price preferences (e.g. the ethical stance of suppliers), uncertainty, consumer preparedness, concerns with the switching process, time pressures and demographic details.

KEY FINDINGS

- We find significant switching costs in the energy market, even after all search costs are eliminated. While switching is positively correlated with the savings offered to participants, the prospect of substantial savings is not by itself sufficient to induce a majority of participants to switch, despite the small additional effort required.
- A range of non-price factors — uncertainty, the non-monetary characteristics of different offers, concerns about the switching process and time pressures when TBS occurred — are all associated with the switching decision.
- Some other results, such as the seemingly disproportionate weight attached to exit fees, and the negative impact of seeing two offers rather than one, may demonstrate elements of behavioural bias. However most of the factors we identify are consistent with consumers making a largely rational decision when choosing not to switch, even if this results in monetary savings being left on the table.

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POLICY ISSUES

- Our finding of significant pure switching costs means that switching cannot be relied on to put all consumers on the cheapest deal for them. Indeed, our results suggest that some consumers consciously choose to remain with more expensive suppliers due to non-price preferences (e.g. regarding a supplier's ethical/environmental stance).
- These non-price preferences mean that consumers do not regard energy as a homogeneous product, despite the view of many analysts. Hence, our second policy conclusion is that forcing consumers to switch supplier may reduce utility for at least some consumers, since they do not regard suppliers as completely interchangeable.
- Third, opt-in collective switching processes do not offer a panacea in terms of getting consumers to switch to cheap energy deals. Opt-in collective switches still rely on consumer engagement, both to choose to take part and to accept the auction offer.
- Since financial savings are associated with switching, policies which restrict available savings are likely to reduce the switching rate. Equally, the proportion of TBS participants not switching suggests that relying on consumers to drive margins down to competitive levels is likely to prove disappointing.
- If even well-educated, highly-engaged, savings-seeking TBS participants did not behave like the model consumers envisaged in an idealised homogeneous product market, policymakers should lower their expectations about the power of consumer engagement to promote competition.

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